INDEX

	Page
Opinions below	1
Jurisdiction	2
Statutes involved	3
Questions presented	4
Statement:	
A. Introduction	5
B. The 1967 inclusion report	10
C. The first round of judicial review	13
D. The 1968 remand report	15
E. Further judicial review and the proceedings in this Court	23
Argument:	
Introduction and summary	26
I. The Commission's remand report properly took into account the additional factors of abandonment delay and the previously unpriced risks of sale in establishing net liquidation value; the three-judge court correctly accepted the Commission's evaluation of these factors and the reorganization court erroneously rejected it	35
A. The Commission's postulation of a one-year abandonment proceeding before liquidation could begin was reasonable, and its determination of the costs of such a delay was rational and supported by substantial evidence	35
1. The record shows that abandonment and liquidation of New Haven could not have begun as a practical or legal matter prior to the date postulated by the Commission	36
2. The estimate of the costs of a one-year delay is conservative and supported by the facts of record	43

379-581—70——1

Argument—Continued

	Page
3. The end result reached by the Commission is fair and equitable	48
B. The bulk sale discount is an appropriate minimum reflection of risks which were not taken into account in the land appraisals and the prior discounts	52
II. The reorganization court improperly substituted its own independent judgment for that of the Commission in valuing real estate and discounting future proceeds to present worth	59
A. The valuation of the Harlem River and Oak Point Yards	59
B. The discount of future liquidation proceeds to present worth	64
III. The issues on which the lower courts agree raise no substantial questions	65
A. New Haven has no lawful interest in income from Grand Central Terminal properties which pays its former share of terminal expenses	65
B. New Haven had no compensable "going concern value" on the valuation date under the liquidation hypothesis	71
C. The Commission fairly and equitably valued the Penn Central common stock	74
1. The valuation properly reflects prospective earnings of Penn Central discounted to present worth	76
2. The underwriting requirement provides unique assurance that the Commission's valuation of the stock will be realized by the New Haven estate	78
D. Penn Central is not required in fairness to shoulder 100% of New Haven's 1968 operating losses	81
E. Adequate and fair values were assigned New Haven's non-operating properties	83
Conclusion	86

CITATIONS

Cases:

	Page
Converse v. *Commonwealth of Massachusetts*, 101 F. 2d 48 *sub nom. Palmer* v. *Massachusetts*, 398 U.S. 79	40
Dayton P. & L. Co. v. *Public Utilities Comm'n of Ohio*, 292 U.S. 290	53, 78
Ecker v. *Western Pacific R. Corp.*, 318 U.S. 448	33, 34
Group of Investors v. *Milwaukee R. Co.*, 318 U.S. 523	75
Interstate Commerce Comm. v. *New York, N.H. & H.R.R.*, 287 U.S. 178	67
New York (Fifth Avenue Coach Lines, Inc.), In the Matter of the City of, 18 N.Y. 2d, 212, 273 N.Y.S. 2d 52; 22 N.Y. 2d 613, 294 N.Y.S. 2d 502	73
Market Street R. Co. v. *Railroad Comm'n of California*, 324 U.S. 548	53
Meyers v. *Jay Street Connecting Railroad*, 259 F. 2d 532	36
New York Central R. Co. v. *New York, N.H. & H.R. Co.*, 13 A.D. 2d 309, 216 N.Y.S. 2d 928, affirmed, 11 N.Y. 2d 1077	68
New York, N.H. & H.R. Co. Discontinuance of Trains, 327 I.C.C. 151	9, 38
New York, N.H. & H.R. Co., In the Matter of, 378 F. 2d 635	82
New York, Ontario and Western Railway Company, et al., Receivers Abandonment, Finance Docket No. 19861	40
New York, O. & W. Ry. Co. Reorganization, 295 I.C.C. 346	41
Norfolk & W. Ry. Co. and New York, Chicago & St. L. R. Co.—Merger, etc., 330 I.C.C. 780, sustained *sub nom.* Penn Central *Merger Cases*, 389 U.S. 486	28
Northern Pacific Railway v. *Boyd* 228 U.S. 482	31
Ohio Bell Tel. Co. v. *Comm'n*, 301 U.S. 292	63
Passenger Fares, New York, N.H. & H.R. Co., 313 I.C.C. 411	6, 7
Passenger Fares, New York, N.H. & H.R. Co., 314 I.C.C. 377	7
Penn-Central Merger Cases, 389 U.S. 486	6, 28, 32, 82
Port Authority Trans-Hudson Corp. v. *Hudson Rapid Tubes Corp.*, 20 N.Y. 2d 457, 285 N.Y.S. 2d 24, 231 N.E. 2d 734, certiorari denied, 390 U.S. 1002	31, 73, 74

Cases—Continued

	Page
Reconstruction Finance Corp. v. *Denver & R.G.W.R.R.*, 328 U.S. 495	82
Rutland Ry. Corp. Abandonment of Entire Line, 317 I.C.C. 393, sustained *sub nom. Brotherhood of Locomotive Engineers* v. *United States*, 217 F. Supp. 98	40
Schwabacher v. *United States*, 334 U.S. 182	36, 75
Unemployment Commission v. *Aragon*, 329 U.S. 143	65, 80
United States v. *L.A. Tucker Truck Lines*, 344 U.S. 33	65, 80
United States v. *Pierce Auto Lines*, 327 U.S. 515	63
Zirn v. *Hanover Bank*, 215 F. 2d 63	47
Statutes:	
Bankruptcy Act, Section 77, 11 U.S.C. 205	33, 34
Section 77	3, 5
Section 77(b)(5)	13
Section 77(c)(6)	46
Section 77(d)	8, 13
Section 77(e)	13, 26, 32
Interstate Commerce Act, 49 U.S.C. 1, *et seq:*	
Section 1(18)	3, 19, 36, 42
Section 1(20)	3
Section 5	34
Section 5(2)	3, 26
Section 5(2)(b)	13
Section 5(2)(d)	13
Section 13a	9
28 U.S.C. 1336(a)	13
28 U.S.C. 2321–2325	13

In the Supreme Court of the United States

OCTOBER TERM, 1969

Nos. 914, 915, 916, 917, 920, 921, 1038, and 1057

THE NEW HAVEN INCLUSION CASES

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK AND ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT BEFORE JUDGMENT

BRIEF FOR THE UNITED STATES AND THE INTERSTATE COMMERCE COMMISSION

OPINIONS BELOW

The opinion of the three-judge district court in the Southern District of New York on July 10, 1968, is reported at 289 F. Supp. 418 (App. 323a–383a).[1] Its opinion of June 18, 1969 (App. 400a–443a) is reported at 305 F. Supp. 1049; its memorandum of September 11, 1969 (App. 444a–445a) is not yet reported.

[1] Appendix pages designated with "a" appear in the "Appendix of Decisions and Constitutional and Statutory Provisions" filed with the jurisdictional statements and petitions. Appendix pages designated with "c" appear in the second volume entitled "Appendix of Significant Dates and Excerpts from the Record."

The opinion of the district court for the District of Connecticut (the "reorganization court") of August 13, 1968, is reported at 289 F. Supp. 451 (App. 237a–260a). Its opinion of May 28, 1969, is reported at 304 F. Supp. 793 (App. 277a–306a); and its final order of July 28, 1969, is reported at 304 F. Supp. 1136 (App. 316a–322a).

The reports of the Interstate Commerce Commission dealt with by the courts below are certain of the supplemental reports in *Pennsylvania Railroad Company—Merger—New York Central Railroad Company,* I.C.C. Finance Docket No. 21989, etc. They are identified and reported as follows:

Second supplemental report, November 16, 1967 ("inclusion report"), 331 I.C.C. 643 (App. 1a–111a);

Fourth supplemental report, November 25, 1968 ("remand report"), 334 I.C.C. 25 (App. 112a–220a);

Fifth supplemental report, July 10, 1969, modified August 26, 1969, 334 I.C.C. 528 (App. 222a–228a);

JURISDICTION

The final decree of the three-judge court was entered on September 11, 1969. Notices of appeal were filed on October 9, 1969 by the First Mortgage 4% Bondholders Committee ("Committee"), appellant in No. 915; the Manufacturers Hanover Trust Company, Trustee ("Manufacturers"), appellant in No. 917; and Chase Manhattan Bank, Trustee ("Chase"), appellant in No. 921.

The decree of the reorganization court was entered on July 28, 1969. Timely notices of appeal to the United States Court of Appeals for the Second Circuit were filed by the bondholder appellants named in the preceding paragraph, by the Penn Central Transportation Company ("Penn Central"), the United States, the Interstate Commerce Commission and the Providence & Worcester Company, and the appeals were docketed in the court of appeals on December 1 and 2, 1969. Petitions for writs of certiorari before judgment in the court of appeals were filed by the Committee, Manufacturers and Chase on December 5, 1969 (Nos. 914, 916 and 920, respectively); by Penn Central on January 5, 1970 (No. 1038); and by the United States and the Commission jointly on January 9, 1970 (No. 1057).[2]

On February 2, 1970, this Court noted probable jurisdiction of the appeals, granted the petitions and consolidated the cases.[3] Jurisdiction over the appeals is conferred by 28 U.S.C. 1253 and jurisdiction on the writs of certiorari by 28 U.S.C. 1254(1).

STATUTES INVOLVED

The pertinent provisions of Sections 1(18), 1(20) and 5(2) of the Interstate Commerce Act, 49 U.S.C. 1(18), 1(20), 5(2), are set out at App. 453a–458a. The pertinent provisions of the Section 77 of the

[2] Providence & Worcester Company filed a petition seeking review of the reorganization court's decision as to certain other matters, as well as appealing from similar aspects of the three-judge court's decision (Nos. 918 and 919, this Term). On February 2, 1970, the Court denied this petition and summarily affirmed as to the matters raised on the appeal.

Bankruptcy Act, 11 U.S.C. 205, are set out at App. 458a–465a.

QUESTIONS PRESENTED

1. Whether the reorganization court—in contrast to the three-judge court which also reviewed the Commission's determination of price under a similar statutory standard—improperly substituted for the Commission's determination its own independent judgment of the liquidation value to be given the New Haven's properties, in the following particulars:

(a) by rejecting the Commission's finding that the liquidation value should reflect (in the amount of $15.4 million) the cost to New Haven of a one-year delay before an abandonment certificate could be obtained;

(b) by rejecting the Commission's finding that the valuation of New Haven's real estate should reflect (in the amount of $6.7 million) the risks not otherwise accounted for that the New Haven would incur in selling its numerous properties;

(c) by substituting its own valuation of $22.5 million for New Haven's Harlem River and Oak Point yards in the Bronx for the Commission's valuation of $18.1 million;

(d) by substituting its own discount of liquidation proceeds to present worth for the Commission's with a resulting increase of $2 million in New Haven's liquidation value.

2. Whether the lower courts, in agreement with each other, correctly rejected other contentions made by the bondholders in seeking to increase the New Haven valuation and the price to Penn Central, holding that:

(a) New Haven has no interest in the $5.6 million of income from Grand Central Terminal properties which helps to pay the terminal expenses;

(b) New Haven had no compensable "going concern value" on the valuation date;

(c) the Commission fairly and equitably valued the Penn Central common stock which formed a substantial part of the consideration paid by Penn Central to New Haven;

(d) the Commission properly concluded that Penn Central should, in addition to including the New Haven on December 31, 1968, also bear $5 million of New Haven's 1968 operating losses rather than 100 percent of those losses;

(e) the Commission properly assigned a zero liquidation value to two relatively minor New Haven stock investments in rail-affiliated concerns which were transferred to Penn Central along with all the other rail properties.

STATEMENT

A. INTRODUCTION

The Penn-Central merger application was filed with the Interstate Commerce Commission in 1962. Three months later, the trustees of the New York, New Haven & Hartford Railroad Company [3]—then in reorganization under Section 77 of the Bankruptcy Act—filed with the Commission a petition requesting that the New Haven be included in the merged Penn-Central system. When this Court sustained the Penn-Central merger, it upheld the Commission's action in

[3] Three trustees were appointed in 1961; today, one trustee administers the estate.

conditioning its approval of the merger on inclusion of the New Haven in the merged company. *Penn-Central Merger Cases,* 389 U.S. 486, 507–511. By consummating their merger on February 1, 1968, the merging parties irrevocably accepted this condition, and the physical inclusion of the New Haven occurred on December 31, 1968. The group of consolidated cases now before this Court concerns the propriety of the financial terms of the inclusion that were ultimately determined by the Commission.

The events that led to the New Haven trustees' inclusion petition and the actual inclusion provide a useful starting point for an understanding of the numerous factors underlying the Commission's conclusions as to the fair price that Penn Central should pay for the bankrupt New Haven's assets.

In 1960, the Commission began a broad investigation of the New Haven in connection with a proposed increase in its passenger fares. It noted that the railroad had derived a profit from freight operations in every year from 1950 through 1959, and concluded that the "chronic and staggering" passenger deficit was the primary cause of the New Haven's serious financial difficulties.[4] The Commission also referred to "the questionable actions motivated by selfish gain" and "the serious errors in judgment" of the New Haven management, including "reckless speculation in New Haven securities; the initiation of policies of deferred maintenance for the purpose of inflating earnings; policies resulting in loss of competent personnel; and

[4] *Passenger Fares, New York, N.H. & H. R. Co.,* 313 I.C.C. 411, 415.

the ill-advised purchase of three lightweight trains and other equipment which could not be operated successfully on the New Haven's lines."[5] However, the Commission then tentatively recommended against a reorganization proceeding, suggesting instead financial assistance from the States or the federal government. If reorganization occurred, the Commission considered it "probable that a sharp curtailment of service would be required at some time within the period of the trusteeship."[6]

A petition for reorganization was, however, filed on July 7, 1961, leading to the continuing proceeding now here on review in Nos. 914, 916, 920, 1038 and 1057. By then the New Haven's cash loss amounted to $1,500,000 per month.[7] In August of that year, the Commission issued a further report regarding the New Haven, discussing a number of other causes contributing to the New Haven's decline, including the failure of management to develop any long-range plan of operations, the disastrous floods of 1955, and the general decline of railroad freight revenues, especially in the East.[8] The Commission again emphasized that some shrinkage of the New Haven plant was necessary and that some lines should be abandoned;[9] without prejudging future abandonment applications, it recommended that the trustees initiate traffic density studies to permit an intelligent plan-

[5] *Id.* at 421.

[6] *Id.* at 424.

[7] See 289 F. Supp. at 456, App. 241a.

[8] *Passenger Fares, New York, N.H. & H.R. Co.*, 314 I.C.C. 377, 382–384.

[9] *Id.* at 385.

ning of future operations and suggested that the trustees consider more than branch lines, since "it may well be that the New Haven's main line is too elaborate for the present and probable future volume of traffic."[10]

On June 19, 1962, the reorganization court granted the trustees' request to petition for inclusion in Penn Central. The trustees had stated to the court, without contradiction, that it was their belief that "the best interests of the public and of the Debtor require that the Trustees also file a petition with the I.C.C. under Section 5(2)(d) of the Interstate Commerce Act * * *."[11]

The initial terms for New Haven's inclusion were proposed by the trustees and Penn Central in an agreement presented for the Commission's approval in 1966, pursuant to Section 77(d) of the Bankruptcy Act, 11 U.S.C. 205(d). The agreement, as originally

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[10] *Id.* at 386. The response of the trustees during the course of the reorganization was to seek abandonment of certain branch lines. The report of the trustees to the reorganization court for the year 1968 includes the following statement: "Since their program to eliminate unprofitable branch lines was instituted in 1961, the Trustees have received authority to abandon approximately 235 miles of line. This mileage represented approximately fourteen percent of that operated by the New Haven in freight service in 1961 * * *". Reorganization court record, p. 7533.

[11] Petition of Trustees for Order 109, p. 2, filed June 8, 1962. Similarly, the reorganization court stated in 1968 in reviewing the inclusion report (289 F. Supp. at 456, App. 242a):

"By about 1963 it became apparent that the inclusion of the New Haven in the Penn-Central merger was the only salvation for the New Haven as an operating railroad, and at that time it was thought to be *the solution which best served the interests of the creditors* as well as the public interest." [Emphasis added.]

reached in 1964, provided for Penn Central's ownership and operation of New Haven's freight service and related facilities in return for a package of consideration, including cash, bonds, and stock. In furtherance of the agreement, the trustees then petitioned for discontinuance of all the New Haven's passenger service. However, the Commission's report and order of April 6, 1966, approving the merger, required the inclusion of both the freight and passenger service; at the same time the Commission authorized discontinuance of one half of New Haven's long haul passenger service.

The Commission's report on the discontinuance matter [12] found a public need for the commuter service provided by New Haven and addressed itself to whether specific portions of the long-haul service were "not realistically responsive to public need." Abandonment of all operations (freight and passenger) was not in issue.[13]

While the appeals were being heard on the issues presented by the Penn Central merger, the Commission went forward with hearings in 1967 on the merits of the proposed agreement on inclusion terms. Hearings were held on the inclusion and reorganization over a period of 37 days, culminating in the inclu-

[12] *New York, N.H. & H. R. Co., Discontinuance of Trains*, 327 I.C.C. 151, 205.

[13] New Haven's application under section 13a of the Interstate Commerce Act, 49 U.S.C. 13a, was limited to the discontinuance of passenger trains. In addition, the Commission then foresaw "no immediate likelihood of liquidation of the New Haven during 1966 or the next few months thereafter" (327 I.C.C. at 173).

sion report of November 16, 1967.[14] With detailed findings, the Commission established a value for the New Haven assets and approved a price for their transfer to Penn Central.

B. THE 1967 INCLUSION REPORT

With certain exceptions and adjustments, the inclusion report adopted the financial terms upon which Penn Central and the trustees had agreed.[15] The trustees and the New Haven's bondholders urged that the estate was entitled to the liquidation value of the New Haven assets. The Commission found that Penn Central had agreed to pay consideration which had a value at least as great as the liquidation value of the assets (even before any deductions for the cost of abandonment delay and the unpriced risks of a parcel-by-parcel sale), and accordingly it approved the price that had been agreed upon.[16]

In considering the liquidation value of the properties to be conveyed to Penn Central, the Commission analyzed the widely differing appraisals of all the New Haven properties presented by the New Haven

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[14] 331 I.C.C. 643; App. 1a.

[15] Besides requiring inclusion of both freight and passenger service, rather than only the freight service which had been agreed upon, the Commission also required Penn Central to lend New Haven up to $25 million over a 3-year period in the event actual inclusion were delayed by litigation. New Haven drew down $14 million from this fund in 1968.

[16] 331 I.C.C. at 692, 697; App. 50a, 55a. The Commission further thought that a "fair upset price" for these New Haven properties under section 77(b) of the Bankruptcy Act, 11 U.S.C. 205(b) (App. 458a), would be less than their liquidation value of $125 million. 331 I.C.C. at 658, 687; App. 16a, 45a.

trustees and Penn Central; after deductions for certain enumerated liquidation expenses and discounting only to present worth, the gross liquidation value figures presented were the following: [17]

Trustees:	
6-year liquidation	$153,247,000
10-year liquidation	135,880,000
Penn-Central:	
10-year liquidation	81,003,000

The Commission, (1) after an adjustment of only $9.2 million,[18] adopted all the asset valuations presented by the trustees, and (2) adopted the trustees' recommended 6-year liquidation period, stating that "the bulk of the liquidation could be completed" in that period.[19] It then subtracted from the resulting figure $32.4 million (the value of assets to be retained by the New Haven estate) and added $13 million as the value of New Haven's interest in the Grand Central Terminal properties, to which the trustees had assigned very little value.

Accordingly, the Commission concluded in the inclusion report that the net liquidation value of the assets to be conveyed to Penn Central was about $125 million as of December 31, 1966, assuming a six-year liquidation actually beginning on that date. This evaluation was made without regard to the delays and expenses that would be occasioned by the necessity of seeking abandonment authority from the Commission

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[17] 331 I.C.C. at 661; App. 19a.

[18] The Commission reduced the trustees' valuation of the sale of certain railroad equipment by $6.2 million, and deducted another $3 million for 1966 depreciation of depreciable property.

[19] 331 I.C.C. at 663; App. 21a.

before an actual liquidation could begin,[20] and also without regard to the effects of certain unpriced risks that the estate would not be able to realize the appraised values. For example, the Commission (and the appraisals presented to it) gave no weight to the adverse effect that the termination of railroad service would have on the value of the real estate in southern New England, although real estate amounted to 60 percent of the New Haven assets.[21] Rather, having determined that the $125 million agreed price was at least as high as the liquidation value of the assets, the Commission simply had no need to consider whether the liquidation value was in fact less than that amount or, if so, how much less.[22]

The Commission valued the consideration to be paid by Penn-Central as follows:

Penn Central stock (950,000 shares)	$83,100,000
Penn Central bonds	20,000,000
Cash	8,000,000
Assumption of the bonds of the Boston and Providence [1]	3,000,000
Purchase price adjustments [2]	9,500,000
Total	123,600,000

[1] The Boston and Providence Railroad, itself in reorganization, was a lessor of the New Haven. The issuance of bonds to the New Haven and New Haven's purchase of all outstanding B&P shares were features of the B&P reorganization plan.

[2] The purchase agreement between the New Haven trustees and Penn Central provided for adjustments of the purchase price, such as for additions and retirements of property after December 31, 1964.

[20] 331 I.C.C. at 704; App. 62a.

[21] 331 I.C.C. at 663, 667; App. 21a, 25a.

[22] During the course of the hearings leading to the 1967 report, certain bondholder groups presented evidence that liquidation of the New Haven would not need to occur, and that a freight-only operation would be profitable. The study was not projected beyond 1965, and for that reason the Commission rejected it as not sufficiently current. 331 I.C.C. at 659; App. 17a. The bondholders did not present any overall liquidation study.

The foregoing figures did not include Penn Central's share of New Haven's operating losses; the value was rounded off to $125 million.

C. THE FIRST ROUND OF JUDICIAL REVIEW

This specification of terms by the Commission in the inclusion report amounted both to the imposition of a condition to the Penn-Central merger under the Interstate Commerce Act (49 U.S.C. 5(2)(b)) and to the formulation of the first step of a reorganization plan for the New Haven pursuant to Section 77 (b)(5) and (d) of the Bankruptcy Act (11 U.S.C. 205(b)(5), 205(d)). Under its latter aspect, the inclusion report was certified to the reorganization court, which was thereupon required to determine, under Section 77(e), whether the plan was "fair and equitable." In addition, a number of parties instituted proceedings for review of the inclusion report—in its aspect as a condition of the merger—by the three-judge court under 28 U.S.C. 1336(a) and 2321–2325; that court was thus called upon to review the Commission's determination, under Section 5(2) (b) and (d) of the Interstate Commerce Act, that the terms of inclusion were "just and reasonable" and "equitable." [23]

[23] The United States had moved to dismiss the three-judge court actions on the ground that the reorganization court had exclusive jurisdiction. The motion was denied, the court noting that "unfortunate as the duplicitous system of review may be, we see no basis on which we can properly decline to exercise the jurisdiction conferred upon us by 28 U.S.C. §§ 1336(a) and 2321–25." 289 F. Supp. at 424–425; App. 325a–326a.

On review, the three-judge court approved the Commission's valuation of the New Haven assets, except in five limited areas:[24]

(1) failure to discount expenses of liquidation;
(2) valuation of New Haven's interest in the Grand Central Terminal properties;
(3) valuation of the Harlem River and Oak Point Freight Yards;
(4) valuation of New Haven's interest in the assets of the Boston & Providence Railroad;
(5) calculation of depreciation for 1966.

The reorganization court agreed that the Commission should reconsider its findings relating to the above matters, except with respect to item (3), where the court would have sustained the Commission's findings as based on substantial evidence.[25] Regarding New Haven's interest in Grand Central Terminal properties (the only one of these matters other than item (3) now still in issue), the three-judge court held, after a detailed examination of the underlying agreements between New Haven and the former New York Central, that the Commission had erred in failing to recognize New Haven's legal interest in one half the surplus income from these properties after payment of terminal expenses; it rejected the contention that the New Haven would be entitled, after quitting the terminal,

[24] 289 F. Supp. at 427–435, 438; App. 330a–350a, 354a.
[25] 289 F. Supp. at 461–464; App. 249a–254a.

to a share in the total net income unreduced by terminal expenses.[26]

During this period of judicial review, the Penn Central common stock rose from a market price in the fifties and low sixties to a high of $86.50 per share for 1968. At the writing of the three-judge opinion the stock price was around $85 per share. Both courts sustained the Commission's stock valuation.

The three-judge court and the reorganization court agreed with each other on the need for certain other adjustments in the value to be given the consideration that Penn Central had agreed to pay,[27] and agreed upon the final conclusion that the matter of inclusion terms be remanded to the Commission for reconsideration and possible rehearing. The reorganization court added that the Commission should also consider early inclusion and partial payment, perhaps before reconsidering the matter of valuation, since the bondholders should not be required to absorb any of the operating losses after January 1, 1969.[28]

D. THE 1968 REMAND REPORT

On August 26, 1968, the Commission reopened its proceedings for reconsideration and an expedited rehearing. At a prehearing conference held September

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[26] 289 F. Supp. at 428–433; App. 333a–343a. The reorganization court asked the Commission to make further findings concerning "what value, if any, attaches to New Haven's present right to share in the income" before expenses. 289 F. Supp. at 463; App. 253a.

[27] 289 F. Supp. at 436–438, 442, 464–465; App. 254a, 350a–353a, 361a.

[28] 289 F. Supp. at 458–459, 465–466; App. 244a–245a, 256a–258a.

10, 1968, the parties described the nature and scope of their proposed new evidence;[29] and the record before the special master appointed by the reorganization court to study New Haven's interest in the Grand Central properties was incorporated by reference.[30] Oral hearings were held from October 7 through October 15, 1968, and the parties exchanged briefs. On November 25, 1968, the Commission entered its report and order on all remaining facets of the inclusion and reorganization.

Most of the new evidence concerned the valuation of the Grand Central Terminal properties. Witnesses for both the bondholders and for Penn Central testified in detail with respect to projected hotel and office building earnings, the past profitability of these properties, and projected expenses of the terminal. The Commission made detailed findings on individual elements of the terminal area valuation.[31]

For example, a close question in the valuation of the Grand Central Terminal properties concerned the proposed "Tower" building over the Grand Central Station. The evidence was that the permission of a New York City commission to construct such a building had not been obtained. If built, the lease of air rights would bring Penn Central and New Haven $2.3 million per year. The Commission resolved the doubt as to ultimate construction in favor of the bondholders. It placed a value of $8 million on New Haven's interest in the air rights, and included the full value in New Haven's liquidation value. The practical result

[29] Tr. 28514 *et seq.*, R. Doc. No. 46.

[30] Tr. 28556, R. Doc. No. 46.

[31] 334 I.C.C. 25, at 30–39; App. 112a, at 117a–126a.

of the rehearing and detailed findings was that the Commission more than doubled its prior valuation of New Haven's interest in the Grand Central Terminal properties (from $13 million to nearly $29 million). As had the three-judge court, the Commission rejected the bondholders' contention that New Haven had an interest in terminal income without any deduction for terminal expenses. The Commission further found that the only customer for New Haven's right to use the station following a liquidation of the New Haven would be the State of New York, which would have sufficient bargaining power to avoid paying for use of the station.[32]

The courts had found that New Haven should have been paid for the $16.2 million of accrued real estate taxes which New Haven would continue to hold as its own liability after inclusion had occurred. The Commission adjusted the price upwards for this amount, but applied a discount on the basis of the discount that would apply to the notes to be issued by the estate in payment of these taxes. When the lower courts criticized the discount as unfounded on review of the remand report, the Commission abandoned the discount, and gave New Haven full credit for the $16.2 million of accrued taxes.[33] The Commission refused throughout the proceeding to reduce the potential tax liability as Penn Central had urged, for the "mere possibility" that the States to whom the taxes were owed would agree to a tax abatement.[34] Following the inclusion

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[32] 334 I.C.C. at 32; App. 119a.

[33] 334 I.C.C. at 529, App. 223a (Fifth supplemental report; see p. 23, note 47, *infra*).

[34] 334 I.C.C. at 41, App. 128a.

date, however, the "mere possibility" became a reality; and on December 22, 1969, the reorganization court approved a stipulated abatement of over $3.2 million in real estate taxes formerly payable by the New Haven to the City of Boston.[35]

The result of the foregoing and other findings,[36] was to increase the prior valuation figure of about $125 million by a substantial amount—that is, to a figure above the amount that had been agreed upon between the trustees of the New Haven and the Penn Central. This required the Commission to consider more deeply the concept of liquidation value and to analyze factors that had not previously been relevant when the agreed price was at least as high as the valuation figure. The Commission explained:[37]

> The net liquidation value of the NH estate is $162.7 million. A property value of this sort inheres in the assets if we assume that the railroad may immediately shut down and begin a 6-year program of selling off the road parcel-by-parcel, and virtually tie-by-tie. It is the valuation we used in the inclusion report to appraise the fairness of the purchase agreement price then available for use. It is now the valuation that the creditors argue they, or the estate, are entitled to as a matter of constitu-

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[35] Order No. 596 of December 22, 1969, page 7977 of the record in the reorganization court.

[36] The Commission also adjusted the discount of the expenses of liquidation, and further adjusted the value of New Haven's investment in the B&P, in response to the criticisms of the two courts. It made detailed findings on the valuation of one of the railroad yards owned by the New Haven; and explained the deduction for 1966 depreciation from the values of New Haven's used engines and cars.

[37] 334 I.C.C. at 54; App. 141a.

> tional law. We next turn to whether the estate is entitled to the foregoing net liquidation value as a matter of law, or whether there are other considerations on this record that should enter into the fixing of a fair price for the NH assets.
>
> * * * * *
>
> In the *inclusion* report, we found that the consideration Penn Central had agreed to pay would equal liquidation value there shown, and that made it unnecessary for us to explore other pricing considerations. The liquidation value that results in this reopened proceeding exceeds the agreed price, obliging us to make a new determination as to whether the price resulting from such a valuation is fair.

Accordingly, the Commission concluded, for reasons summarized below, that the valuation of the properties should further reflect the cost to New Haven of a one-year delay before abandonment could begin and the risks that New Haven would incur if it sold its properties in a six-year marketing program.

Abandonment delay.—The Commission explained that a railroad can not withdraw itself and abandon its line without Commission approval under Section 1(18) of the Interstate Commerce Act, 49 U.S.C. 1(18). No such application had ever been presented to the Commission, and the public had never been heard. The Commission added, "it would not be possible to conclude an abandonment proceeding in less than a year in a matter involving the complexity and size of the NH system. If the States or the Federal Government requested time to prepare studies, as we think they might, the time lapse between the filing

of the application and the decision would approach 2 years."[38] Assuming only a one-year delay, the Commission found that the consequences would be (1) an additional waiting period of one year before receipt of any liquidation proceeds, and hence an additional discount of those proceeds to present worth of $7,946,000;[39] (2) expenditure by the New Haven estate of $4,940,000 in preservation costs, based on estimates prepared by a New Haven trustee; and (3) an additional accrual of $2,500,000 in real estate taxes. Thus, the assumed one-year delay before the beginning of liquidation would bring a total diminution in the worth of the New Haven estate of at least $15,386,000.[40]

Bulk sale discount.—The Commission further pointed out that the prior valuation had proceeded on the assumption that the net proceeds from selling individual real estate parcels was immediately available to the estate, subject only to a discount for the cost of money. The prior computation had not reached the problem of fully valuing the risks that the appraised values could not be obtained once the railroad service was abandoned. For example, the inclusion report had stated that the appraisals there relied on had given no weight to the possible impact of a New Haven abandonment on the real estate market generally.[41] The Com-

[38] 334 I.C.C. at 59; App. 146a.

[39] *Ibid.* The discount was applied to $149.7 million of net receipts that the New Haven would obtain upon a sale of individual assets over a period of 6 years after abandonment was approved (see 334 I.C.C. at 59–60; App. 146a–147a). The discount amounts to 5 percent of those receipts.

[40] 334 I.C.C. at 60; App. 147a.

[41] 331 I.C.C. at 667; App. 25a.

mission, therefore, reasoned that the figure of $162.7 million overstated a true liquidation value, and that a bulk buyer was entitled to a discount for assuming the risks that the estate avoided. The Commission stated that following such a discount, "as a practical matter the bondholders will receive the full economic equivalent of the liquidation value of the assets. The bulk-sale discount merely reflects a market appraisal of the risks that the estate avoids, and the bulk buyer assumes."[42] Of the $149.7 million of projected net liquidation receipts, the Commission applied the bulk-sale discount against only the net land receipts of $85.5 million.[43] Based on the minimum financial terms a bulk buyer of land could expect, the Commission computed a bulk sale discount of $6,695,000.[44]

The remand report correspondingly increased the net consideration to be received by the estate by $21.2 million,[45] as shown on the following table (in millions):

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[42] 334 I.C.C. at 61; App. 148a.

[43] 334 I.C.C. at 62, App. 149a.

[44] *Ibid.* The discount amounted to 4.5 percent of total net receipts, or 7.8 percent of the net land receipts.

[45] The total of $145.6 million to be paid by Penn Central equals the sum of the net valuation of $140.6 million for the assets determined in the remand report and $5 million of 1968 losses by the New Haven that Penn Central was required to assume (see pp. 30, 81–83, *infra*).

Value of the consideration to be received by New Haven

	Inclusion report	Remand report
1. Penn-Central stock	$83.1	$83.1
2. Penn-Central bonds	20.0	27.4
3. Cash	8.0	8.0
4. Assumption of Harlem River Division bonds		8.9
5. Assumption of Boston & Providence bonds [1]	2.4	2.4
6. Purchase price adjustments:		
a. Cancellation of trustees' certificates		14.0
b. Additional Penn Central bonds	[2] 8.2	1.8
7. Loss sharing	[3] 5.0	(4)
8. Total to be received from Penn-Central	126.7	145.6
9. Payment to B&P public holders [5]	−2.3	
10. Net total	124.4	145.6

[1] Value after partial repayment.

[2] The suggestion of the three-judge court (289 F. Supp. at 437–38; App. 353a) was accepted by the Commission (334 I.C.C. at 69–70; App. 156a–157a).

[3] For 11 months from February 1, 1968, the date of consummation of the merger, to December 31, 1968, the date of actual inclusion.

[4] Included in "purchase price adjustments."

[5] In the inclusion report, the Commission did not question the requirement of the purchase agreement between the trustees and Penn Central that the trustees pay for the public shares of the Boston and Providence Railroad. No party questioned this requirement either during the prior hearings or during the proceedings on remand. On its own motion, the Commission shifted to Penn Central, the ultimate holder of the shares, the burden of paying the B&P public holders $2.3 million (334 I.C.C. at 52; App. 139a).

The remand report then discussed the continuing cash losses resulting from operation of the New Haven, and required Penn Central to include the New Haven on or before January 1, 1969, whether or not final judicial review of the terms had occurred. Prior to judicial review of the remand report on the merits, Penn Central sought to block an end-of-the-year inclusion of the New Haven in both the reorganization court and the three-judge court on the ground that the purchase price had not been finally determined. Both courts sustained the decision insofar as it required immediate inclusion.[46]

[46] App. 263a, 387a.

E. FURTHER JUDICIAL REVIEW AND THE PROCEEDINGS IN THIS COURT

The New Haven's bondholders (who would be the beneficiaries of the payment for the properties made by Penn Central to the New Haven estate), and Penn Central then initiated a new round of litigation in both the reorganization court and the three-judge court, contesting aspects of the remand report that were unfavorable to them. On May 28, 1969, the reorganization court (Circuit Judge Anderson) issued an opinion sustaining the remand report in large part but setting it aside with respect to four key items affecting the price to be paid by Penn Central, with the effect of increasing that price substantially. Following the issuance of this opinion, the three-judge court on June 18, 1969, in an opinion by Circuit Judge Friendly (in which District Judge Levet concurred and from which District Judge Weinfeld dissented), sustained the Commission's price determination except in minor respects.[47]

[47] The Commission accepted Judge Friendly's criticisms of its order, and its fifth supplemental report (334 I.C.C. 528, App. 222a) amended its order to conform with the three-judge court's opinion prior to entry of the court's decree. The Commission, for example, accepted in principle the underwriting requirement suggested by both courts (334 I.C.C. at 532; App. 226a; see discussion at pp. 78–81, *infra*).

In addition Judge Friendly held that the value of the consideration had been overstated in a manner that had not entered into Judge Anderson's opinion. Judge Friendly held that the Commission erred in valuing Penn Central's assumption of the Harlem River Division bonds at their face value. The Commission subsequently agreed with the court and amended its order to incorporate a discount of $483,270 to the face amount of these bonds (334 I.C.C. at 530; App. 224a).

Both the three-judge court and the reorganization court accepted the Commission's criterion for pricing the New Haven properties—their liquidation value as of an appropriate date. On this basis, Judge Friendly's majority opinion carefully considered the conclusions that Judge Anderson had reached in his opinion in the reorganization court, as well as the similar views that Judge Weinfeld expressed in his dissenting opinion. The opinion concluded by stating:

> Essentially, we think our disagreements with Judge Anderson and Judge Weinfeld reflect a difference in view concerning how far we are at liberty to substitute our own notions for the decisions the Commission has taken * * *. [App. 421a.]

The effect of the conflict between the approaches of the two courts is a difference of approximately $29 million in the price that Penn Central would have to pay for the New Haven properties. The three-judge court approved, and the reorganization court disapproved, the adjustments made in the remand report to take account of a one-year abandonment delay and the bulk sale discount. In addition, the reorganization court disagreed with the Commission's valuation of the Oak Point and Harlem River yards and with the Commission's discount of liquidation proceeds to present worth.

The disagreements between the two courts may be summarized as follows:

Item	Commission valuation as sustained by 3-judge court	Reorganization court's substituted value	Difference
Cost of 1-year abandonment delay	$15,386,000	0	$15,386,000
Discount of land when valued in bulk	6,695,000	0	6,695,000
Value of Harlem River and Oak Point yards	18,100,000	$22,539,000	4,439,000
Discount of liquidation receipts to present worth	[1] 17,153,000	[2] 15,147,101	2,005,899
Total			$28,525,899

[1] $17,563,000 (331 I.C.C. at 661; App. 19a) less $410,000 (334 I.C.C. at 530; App. 224a).
[2] $17,563,000 less $2,415,899 (App. 318a).

Appeals from the order of the reorganization court to the United States Court of Appeals for the Second Circuit were then taken by the Commission, the United States, Penn Central and the three bondholder groups that are now appellants and petitioners here. Some of the appeals related to the inclusion terms, or "Step 1" of the reorganization court's decision; others related to "Step 2" of that decision, which concerns the distribution of the proceeds of the New Haven sale among the New Haven's creditors. The court of appeals consolidated the appeals before it into two groups—one consisting of all of the Step 1 matters and the other of all of the Step 2 matters—but has not proceeded further toward briefing or argument of the appeals. The writs of certiorari before judgment raise in this Court all of the unresolved Step 1 issues (except those raised in the petition of Providence & Worcester, which the Court has denied), and the Step 2 matters remain for resolution in the court of appeals after this Court disposes of the cases before it. In addition, the three bondholder groups have appealed directly to this Court from the decision of the three-judge court.

The positions of the various parties in this Court may be summarized as follows: The Commission, the United States and Penn Central support the decision of the three-judge court and attack the decision of the reorganization court only to the extent that it differs from the decision of the three-judge court. The three bondholder groups—the Committee, Manufacturers, and Chase—support the decision of the reorganization court on the points on which it differs from the three-judge court and also attack both decisions on a number of common points. The New Haven trustee, an appellee and respondent, generally supports the position of the bondholders.

ARGUMENT

INTRODUCTION AND SUMMARY

We believe that there can be no serious disagreement as to the following basic propositions of law that govern these cases: (1) that the Commission's role under the statutory schemes of the Bankruptcy Act and the Interstate Commerce Act is, in the circumstances of this case, the same—that is, to determine an appropriate price for the conveyance of the New Haven assets to Penn Central; (2) that the statutory standards that should guide the Commission and the reviewing courts are the same under both statutes, there being no pertinent difference between the "fair and equitable" standard of Section 77(e) (11 U.S.C. 205(e)) and the "just and reasonable" and "equitable" standard of Section 5(2) (49 U.S.C. 5(2) (b) and (d)); and (3) that the scope of judicial review

under the two statutory schemes is the same. Moreover, although the bondholders contend that the price determined by the Commission and approved by the three-judge court, after its consideration of the reorganization court's decision, violated their alleged constitutional right to no less than the New Haven's net liquidation value, we shall show that no such constitutional question is raised here since the Commission in fact applied that net liquidation value criterion. Accordingly, we believe, with the three-judge court, that the only issue is whether, under conventional standards of judicial review of agency action, the Commission's determinations of net liquidation value as of December 31, 1966, and the value of the consideration to be given by Penn Central were rational and supported by substantial evidence. Insofar as the courts below differed, we believe those differences arise only from the reorganization court's failure to adhere to the proper standard of judicial review; insofar as the courts below agreed, we believe that the attacks upon their conclusions made in this Court are without substance.

Because the matters in question are factually complex, our discussion of them will be unavoidably voluminous. But this should not obscure the simplicity of the underlying issue. That issue, and the correctness of the three-judge court's approach to it will, we think, be made clear by a brief overview of what the Commission determined.

The Commission's 1967 inclusion report was the product of a proceeding focused on the purchase agreement negotiated between the New Haven trustees

and Penn Central. That agreement was the culmination of the voluntary efforts looking toward the New Haven's inclusion that had been begun in 1962, without objection from the bondholders, by the filing of the trustees' petition for inclusion. Until 1967, no bondholder had opposed reorganization by way of inclusion, and by that time the inclusion route chosen by the bulk of the creditor interests was for all practical purposes unalterable.[48] The inclusion report reflected the Commission's careful consideration of the trustees' appraisals of the New Haven assets—which the Commission for the most part accepted—and concluded that the consideration (worth about $125 million) that Penn Central had agreed to deliver to the trustees was at least as valuable as the New Haven assets that Penn Central was accepting in the inclusion. It was, therefore, unnecessary for the Commission to examine certain assumptions underlying the trustees' appraisals, such as that New Haven could on the valuation date (December 31, 1966) immediately begin to dismantle the properties and commence a six-year liquidation program.[49]

[48] In 1967 the Committee and another bondholder sought termination of the reorganization proceeding and liquidation of the assets, but the reorganization court refused to do so in February 1968, noting that the request was not endorsed by the other bondholders or creditors. 281 F. Supp. at 68–69; App. 235a.

[49] As the Commission explained in *Norfolk & W. Ry. Co. and New York, Chicago & St. L. R. Co. merger, etc.*, 330 I.C.C. 780, 800 (1967), sustained *sub nom. Penn Central Merger Cases*, 389 U.S. 486 (1968), "where a transaction is bargained at arm's length, each side is 'presumably capable of determining their own best interests' ".

The first round of judicial review—on which the three-judge court and the reorganization court were in substantial agreement—drastically changed the situation. While agreeing that net liquidation value as of December 31, 1966, was a proper measure of the price to be paid, the courts set aside the Commission's determination that that value did not exceed the agreed price of $125 million, holding that a limited number of the Commission's findings were not supported by substantial evidence. Accordingly, in the remand proceeding the Commission was faced with the more exacting task of determining just what the appropriate liquidation value was. And, although the remand report expressed the Commission's doubt that net liquidation value was the *only* lawful standard (a matter that had been left open on the first round of judicial review), it did—as the three-judge court later held—recalculate net liquidation value in a more precise manner. Understandably, this more precise recalculation required the Commission to look more closely at some of the assumptions upon which the original findings had been based.

Even assuming all trains stopped running on the valuation date, the Commission found in the remand report that liquidation could not begin without affording the public an opportunity to be heard in an abandonment proceeding under section 1(18) of the Interstate Commerce Act. The Commission found that such a proceeding would take at least one year and that the liquidation value would decline by at least $15,386,000 during this one-year period preced-

379-581—70——3

ing the commencement of actual liquidation. Moreover, the Commission found that there were risks of a six-year liquidation program that had not been fully priced out in the earlier appraisals, and therefore, based on the evidence presented by Penn Central at the hearings on remand, that the liquidation value of the estate on December 31, 1966, had been overstated in the inclusion report by at least $6,695,000. On the basis of these factors and its further consideration of the matters to which the courts had objected in remanding the case, the Commission now found that the net liquidation value of the New Haven estate as of December 31, 1966, was $140,600,000. Accordingly, it determined that Penn Central should be required to pay that amount, plus $5,000,000 towards New Haven's 1968 operating losses.

The reorganization court on its further review and the bondholders in their briefs in this Court have called the Commission's addition of these "abandonment delay" and "bulk sale" elements a betrayal of the net liquidation value approach to pricing, which they contend is required for the preservation of the New Haven creditors' constitutional rights. The three-judge court took what we consider a better approach: It declined to view net liquidation value as a rigid concept and acknowledged the propriety of the Commission's reconsideration of what should go into that concept after rejection of the agreement between the parties drastically changed the nature of the Commission's inquiry. Concluding that it was reasonable

to include these two new factors in determining net liquidation value as of December 31, 1966—for reasons that we elaborate *infra*—the three judge court held that the Commission had in fact acted in accordance with the constitutional standard asserted by the bondholders, making it unnecessary to decide whether that standard was an inexorable one. Thus, there is no constitutional question raised here.[50]

We submit therefore that the differences between the two courts below on these two major matters resolve themselves into questions of the scope of judicial review, that is, whether the three-judge court properly concluded that the Commission's treatment of these factors was based upon rational economic judgments and findings supported by substantial evidence. Plainly, the two remaining points of difference between the

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[50] In any event, we believe that the Commission was correct in its view that the Constitution does not prescribe liquidation value as the only minimum valuation acceptable under Sections 5 and 77. See 334 I.C.C. at 53–57, App. 140a–144a. If the Commission had found that New Haven could have been reorganized to produce, let us say, $1,000,000 of income available for fixed charges, the Commission could have valued the New Haven by capitalizing that income. Neither equity nor the Constitution would then have required the Commission to permit an abandonment merely because the future earnings would fail to reach an adequate return on the liquidation value of the properties for their highest and best use. In other cases, liquidation value may in fact be too low a valuation of the properties, such as in the *PATH* case, cited by the bondholders (*Port Authority Trans-Hudson Corp.* v. *Hudson Rapid Tubes Corp.*, 20 N.Y. 2d 457, 285 N.Y.S. 2d 24, 231 N.E. 2d 734 (1967), certiorari denied, 390 U.S. 1002).

two courts—the propriety of the Commission's valuation of the Harlem River and Oak Point yards and of its discount of liquidation receipts to present worth—raise only scope of review questions, as do the bondholders' attacks upon other findings by the Commission that the courts agreed in affirming. And we shall show in the following sections of this brief that the Commission's evaluation of all of these factors is legally and factually supportable.

In discussing the relative roles of the courts and the Commission in this case, Judge Friendly's majority opinion for the three-judge court properly stressed "the severe limitations on the scope of our review."[51] As this Court stated in the *Penn-Central Merger Cases*, 389 U.S. 486, the function of a reviewing court in an inclusion proceeding is "to guard against the possibility of gross error or unfairness." If a court finds the Commission's "conclusions to be equitable and rational," it should not "second-guess each step in the Commission's process of deliberation" (389 U.S. at 524). The various "factors of particularized judgment and the weight to be ascribed to various values * * * are matters as to which reasonable men may reasonably differ in detail * * *" (*ibid.*). The essential question on review of financial terms of an inclusion order is whether the "terms fixed by the Commission are * * * within the area of fairness and equity" (389 U.S. at 526). Similarly, Section 77(e) of the Bankruptcy Act, 11 U.S.C. 205 (e), in its final paragraph delegates the valuation

[51] 305 F. Supp. at 1053; App. 404a.

function to the Commission. In reorganizations, "[v]aluation is a function limited to the Commission, without the necessity of approval by the [reorganization] court"; Section 77 leaves the determination of value to the Commission, "when that determination is reached with material evidence to support the conclusion and in accordance with legal standards." *Ecker* v. *Western Pacific R. Corp.*, 318 U.S. 448, 472–473 (1943).

As Judge Friendly properly observed, "[s]uch considerations [limiting the judicial role] are peculiarly applicable to a determination so hypothetical as the liquidation value of the New Haven. What that really is, no one ever has known or ever will know, even approximately." [52] And specifically with reference to the propriety of the "abandonment delay" that the Commission took into account in the remand report, Judge Friendly found that

> Passing on the reasonableness of such a determination requires a reviewing court to enter a never-never land. The Commission had to estimate the starting date of a liquidation that never happened, that in the world as we know it scarcely could have happened, and that, if it had happened, could have happened in any one of a number of equally imaginary ways, each based on a different pattern of demands on governmental authority that were never made, and ensuing administrative and judicial proceedings that never occurred.[53]

In sum, Judge Friendly considered that "the overwhelming bulk of the attacks concerns the Commission's economic judgments," and added, "With respect

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[52] 305 F. Supp. at 1053; App. 404a.

[53] 305 F. Supp. at 1056; App. 411a.

to these we must be on guard lest the familiarity about the facts of the case we have somewhat painfully gained should lead us simply to substitute our views for those of the agency which Congress has appointed." [54]

Much of the presentation of the bondholders assumes that finding liquidation value was merely a matter of adding up particular figures produced by various witnesses and resolving all doubts in favor of the highest value. The Commission's responsibility, however, was to reach a fair judgment of its own, carefully weighing often conflicting evidence produced during the course of lengthy proceedings. Both Section 5 of the Interstate Commerce Act and Section 77 of the Bankruptcy Act confer this difficult and complex task upon the Commission, and we believe that the three-judge court gave proper deference to the Commission's careful conclusions. On review of the inclusion report, the reorganization court had observed the proper standard, citing *Ecker* for the correct proposition that "a new finding of value * * * lies in the sole province of the Commission." [55] On review of the remand report, however, the reorganization court improperly reversed itself in this regard and substituted its own independent judgment for that of the Commission on each of the four factors on which it differed from the three-judge court. To that extent, the reorganization court's decision

[54] 305 F. Supp. at 1054, App. 406a.
[55] 289 F. Supp. at 463; App. 252a.

should be reversed; *a fortiori,* this Court should not accept the bondholders' invitation to substitute a judgment of its own for the Commission's judgment in those other areas where both courts below accepted it.

I. THE COMMISSION'S REMAND REPORT PROPERLY TOOK INTO ACCOUNT THE ADDITIONAL FACTORS OF ABANDONMENT DELAY AND THE PREVIOUSLY UNPRICED RISKS OF SALE IN ESTABLISHING NET LIQUIDATION VALUE; THE THREE-JUDGE COURT CORRECTLY ACCEPTED THE COMMISSION'S EVALUATION OF THESE FACTORS AND THE REORGANIZATION COURT ERRONEOUSLY REJECTED IT

A. THE COMMISSION'S POSTULATION OF A ONE-YEAR ABANDONMENT PROCEEDING, BEFORE LIQUIDATION COULD BEGIN WAS REASONABLE, AND ITS DETERMINATION OF THE COSTS OF SUCH A DELAY WAS RATIONAL AND SUPPORTED BY SUBSTANTIAL EVIDENCE

As we have indicated, the Commission's calculation of net liquidation value on remand included a deduction for the cost to the New Haven estate of obtaining the administrative approval that would be necessary before it could hypothetically abandon service and begin the six-year liquidation process. For this purpose, the Commission assumed that the authority would be granted at the end of the administrative proceeding (which would nonetheless, as we shall show, serve a valid and necessary function), and considered only the minimum costs to the estate of the one-year delay.

The premise that the New Haven would have to seek a certificate from the Commission before undertaking an abandonment and liquidation was based on the Commission's authority, and the correlative duty

of the New Haven, under section 1(18) of the Interstate Commerce Act, which provides that

> [N]o carrier by railroad subject to this part shall abandon all, or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment. * * *

The principle of law asserted by the Commission was no broader than that a railroad—whatever its financial state—cannot go out of business without affording the public an opportunity to be heard, a principle that had obtained for half a century.[56] The Commission reasoned that the cost of affording such an opportunity, insofar as it affected value, might properly be counted in the valuation process. We will show that the concept was reasonable and that the Commission estimated a conservatively low cost to the New Haven of the year that would be devoted to the hypothetical abandonment proceeding.

1. The record shows that abandonment and liquidation of New Haven could not have begun as a practical or legal matter prior to the date postulated by the Commission

The Commission valued the New Haven properties on a liquidation basis as of December 31, 1966, the latest date available for a decision in 1967. Judge Friendly noted that the Commission's computation of the cost of the New Haven's obtaining an abandonment certificate before commencing liquidation simply

[56] See *Schwabacher* v. *United States*, 334 U.S. 182, 201; *Meyers* v. *Jay Street Connecting Railroad*, 259 F. 2d 532, 536 (C.A. 2).

assumed that actual liquidation would not have begun until January 1, 1968.

The bondholders' claim, that abandonment would actually have occurred sooner but for the inclusion proceedings, is contradicted by the positions they themselves took before the Commission throughout 1967 and in the lower courts in early 1968. During the 1967 hearings, the bondholders introduced a study which appellant Manufacturers argued "showed that it was feasible to operate the New Haven profitably as a freight-only railroad."[57] The other bondholder appellants made similar contentions at that time.[58] As late as March 15, 1968, Manufacturers was arguing that the bondholder witness Wyer had shown,[59]

> that it was feasible to operate the New Haven profitably as a freight-only railroad and that such a railroad could generate sufficient income from the sale of surplus property and from its annual net income to make the necessary improvements.

The Commission, once it reached the issue in the remand report, could not have assumed in light of the foregoing representations that a complete abandonment of the New Haven could have occurred on January 1, 1967. The Commission had rejected the bondholder study in 1967 on the grounds it had not been projected beyond 1965.[60] Clearly, however, public agencies, and particularly shippers dependent upon New Haven freight service, would have been entitled to make

[57] App. 231c–232c.
[58] App. 233c–234c.
[59] App. 251c.
[60] 331 I.C.C. at 659, App. 17a.

an updated showing in 1967 of the feasibility of operating the New Haven as a freight-only railroad, if abandonment had been in the offing. The bondholders' argument that the public had ample opportunity to make just such a showing during the 1967 hearing on New Haven's inclusion in Penn Central is insubstantial, since there has never been any application by the New Haven to abandon its operations. It was not until 1967 that any party to the reorganization proceeding even suggested liquidation, a suggestion that the reorganization court rejected in February 1968.

The reorganization court's speculation in 1969 that but for the inclusion proceeding, "abandonment proceedings could and would have been commenced in late 1963 and liquidation would have been started, certainly by the valuation date of December 31, 1966"[61] is inconsistent with that Court's finding in February 1968 that by the fall of 1967,

> there was some increase in cash from various sources; and by carefully husbanding its resources, the Trustees were able to keep the Railroad going through the balance of the year."[62]

It is further inconsistent with that court's finding in 1968 that the rate of loss and out-flow of cash, among other factors, would constitute a taking of the New Haven's property only after December 31, 1968.[63]

In New York, N.H. & H. R. Co. Discontinuance of Trains, 327 I.C.C. 151, decided April 5, 1966, the Commission authorized discontinuance of one-half the

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[61] 304 F. Supp. at 801; App. ~~258a~~. 285a

[62] 281 F. Supp. at 67, App. 232a.

[63] 289 F. Supp. at 459, App. 245a.

New Haven's interstate passenger trains based on the showing then made by the trustees independently of the prospects for New Haven's inclusion in Penn Central. The Commission found no immediate likelihood of liquidation of the New Haven (at 173), and considered the public need for particular trains or groups of trains on their merits (at 205).

Thus, there is no reason to think that, if there had been no inclusion proceeding in progress, the processes looking toward liquidation (*i.e.*, the filing of an application for an abandonment certificate) would have been begun before late 1967, if indeed they would actually have been begun then. Moreover, even if a petition for abandonment had been filed while the inclusion proceedings were pending and before the Penn-Central merger actually occurred, Manufacturers' brief asserts that "the courts would not, in the public interest, have allowed the New Haven to abandon the proceedings and liquidate" "pending the outcome of those proceedings, citing both the three-judge court and the Commission.[65] It does not follow, however, that such a deferral would have been "the practical equivalent of the denial of an application for abandonment," as the bondholders argued below.[66] Rather, as the three-judge court later held, the possibility of such a deferral means that the Commission might have assumed an even later start of the liquidation period, "after the right to inclusion

[64] Manufacturers' Brief, p. 36.

[65] 289 F. Supp. at 444, App. 366a; and 334 I.C.C. at 59, App. 146a.

[66] 305 F. Supp. at 1056, App. 410a.

[had] accrued." [67] In the court's view "the possibility more logical starting date" for the liquidation would have been February 1, 1969, one year after the consummation of the Penn Central merger—or more than two years after the valuation date.[68]

The Commission acted well within its discretion in concluding in the remand report that an application for abandonment of facilities of the size and complexity of the New Haven's could not be heard and decided in less than one year. The abandonment of a much smaller railroad in the same area of the country had taken 10 months to conclude before the Commission and another 10 months in court.[69] In *Converse* v. *Commonwealth of Massachusetts,* 101 F. 2d 48 (C.A. 2), affirmed *sub nom. Palmer* v. *Massachusetts,* 308 U.S. 79, the court of appeals considered a one-year delay reasonable in the context of an abandonment of only some service of only one New Haven subsidiary (Old Colony Railroad).

The bondholders stress that one prior abandonment proceeding, *New York, Ontario and Western Railway Company, et al., Receivers Abandonment,* Finance Docket No. 19861, was concluded in 1957 only three months after the application was filed. In that case, however, the Commission had previously conducted extensive proceedings extending over a year and one-half, resulting in a recommendation to dismiss the re-

[67] 305 F. Supp. at 1058, note 4, App. 416a.

[68] 305 F. Supp. at 1058, App. 416a.

[69] *Rutland Ry. Corp. Abandonment of Entire Line,* 317 I.C.C. 393 (1962), sustained *sub nom. Brotherhood of Locomotive Engineers* v. *United States,* 217 F. Supp. 98 (N.D. Ohio, 1963).

organization which the court followed. ~~This~~ Thus the issues with respect to the much smaller railroad involved there had been fully explored in advance, see *New York, O. & W. Ry. Co. Reorganization.* 295 I.C.C. 346, 362, and the abandonment proceedings were essentially pro forma; this would not be the case if service of the importance of the New Haven's were sought to be abandoned.

The reorganization court essentially ignored the fact that the Commission had postulated only a one-year period for processing an application to abandon the New Haven.[70] It stated, without foundation, that the Commission would simply "hold up" liquidation of the New Haven without "any limitation on itself," and would exercise "an almost completely unrestricted discretion" in the matter.[71] The three-judge court, on the

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[70] The Commission assumed that the estate would not bear any cash operating losses in that period, nor did it give any consideration to depreciation of asset values. It assumed that appraised values would not change materially in one year. The trustees' liquidation study used the same appraised values whether liquidation occurred in a 6-year or in a 10-year period. See 331 I.C.C. at 661, second table; App. 19a.

[71] 304 F. Supp. at 800, 801, App. 283a, 285a, 286a.

Similarly inapt is the reorganization court's charge that the concept of abandonment delay was a new concept thought up by the Commission in the remand report as a "transparent pretext" to confer "a benefit" on Penn Central. 304 F. Supp. at 804–805; App. 291a. In fact, the record shows that the concept of the costs of an abandonment proceeding was clearly set forth in the inclusion report and that it had previously been referred to with apparent approval by the reorganization court.

In describing the alternatives potentially available to the bondholders in its inclusion report, the Commission stated that the bondholders would not gain from liquidation more than the price fixed by the Commission, since the price then fixed

other hand, accepted the acknowledgedly hypothetical one-year delay between an assumed decision to liquidate and the date when such abandonment of service could actually begin as rational under all the circumstances, including (1) the fact that no one had actually proposed liquidation until 1967; (2) the need for Commission authorization under Section 1(18); (3) the fact that the interested state governments would certainly have introduced into the abandonment proceedings proposals to take over such facilities as were deemed essential, proposals which as a practical matter they would not have formulated until abandonment became imminent; and (4) the fact that the date when the Commission assumed liquidation would actu-

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had omitted the costs of abandonment delay. The Commission stated that, if the bondholders pursued the liquidation route, they "might well have to carry the NH's operating losses until those proceedings were completed and the NH were allowed to abandon its operations * * *". 331 I.C.C. at 704; App. 62a.

The reorganization court quoted this finding in February 1968 in denying the petition of the bondholders to dismiss the reorganization proceeding. The bondholders had urged, among other things, that the highest amount would be realized only through liquidation. The court prefaced its quotation of the Commission finding with the comment that the Commission did not concede its inclusion report had derived a liquidation value "as 'net' as the cross-petitioners [the Committee and another first mortgage bondholder] claim * * *." 281 F. Supp. at 68; App. 235a. In the same vein, the reorganization court repeated on review of the inclusion report that even if the reorganization proceedings were dismissed and the New Haven trains stopped, actual "liquidation will have to await authority to abandon * * *" 289 F. Supp. at 459; App. 245a. Only on review of the remand report did the reorganization court express its newly adopted position that only a formality remained, or that somehow the New Haven could avoid an abandonment proceeding altogether under section 1(18) and begin liquidation without an abandonment certificate.

ally begin even preceded the date when the Penn-Central merger occurred and the right to inclusion thereby accrued. We submit that the three-judge court plainly took a more accurate and reasonable view of the Commission's approach to the problem.

The bondholders complain that the majority of the three-judge court sustained the Commission's finding of the cost of seeking an abandonment certificate when it had refused to make that computation itself in its first opinion.[72] There is no inconsistency. The three-judge court stated in its first opinion only that *it* could not deduct interim cash losses,[73] properly preserving to the Commission the valuation function. The three-judge court added that the function of the abandonment statute, as well as the reorganization provisions, was "to assure orderly procedures and to afford methods that might avoid the ultimate solution."[74] Consistent with both statements, it later approved the costing of procedures which would afford the public an opportunity to be heard.

2. The estimate of the costs of a one-year delay is conservative and supported by the facts of record

The Commission's computation of the one-year costs includes the following elements of cost:[75]

Additional discount of proceeds to present worth	$7,946,000
Preservation costs	4,940,000
Additional accrual of real estate taxes	2,500,000
Total	15,386,000

[72] For example, see Chase Brief, pp. 59–60; Committee Brief, p. 71, second footnote.

[73] 289 F. Supp. at 438–439, App. 354a–355a.

[74] 289 F. Supp. at 441, App. 360a.

[75] 334 I.C.C. at 59–60, App. 146a–147a.

Such costs exclude all operating expenses of the railroad, on the assumption the railroad has stopped running trains while the abandonment proceeding is heard. The computation also excludes any element of depreciation of the plant during the year of the proceeding. The costs are only those during a relatively short time span that are readily ascertainable from the record.[76]

Additional discount to present worth.—The Commission found that New Haven would experience a further discount to present value of $7,946,000 if it applied for abandonment, since all realization of the proceeds of liquidation would have to be deferred for another year. The bondholders assert that the discount should be less because the sales of real estate could be somehow accelerated, but the record does not support their assumption.[77]

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[76] The Committee argues (p. 80), citing 334 I.C.C. at 62, note 2 (App. 149a), that the Commission already built in a "six-months delay" in the computation of the discount to present worth. The statement misconstrues the record. In that discount, the witnesses and the Commission assumed that cash flows would accrue at midyear. It was, therefore, assumed that all first year proceeds would be received six months after the start of liquidation. The assumption of mid-year accruals was simply for convenience of computation. Otherwise, many different fractional discount factors would have been required to determine the precise discount depending upon whether individual proceeds were received in the second, third, eighth or ninth months of any year. A mid-year accrual gave an average accrual for the annual period. See Gordon testimony, Tr. 23419, App. 207c; Altman (bondholder witness), Exh. R–39, App. A, last footnote, App. 373c; Hull (Penn Central) witness), Exh. R–38, p. 9, App. 361c.

[77] In this connection, the trustees's witness Gordon described a six-year liquidation period as "admittedly optimistic" (Exh. NHI–41, p. 13, App. 48c); and witness Mason suggested a six-year period would be "on the low end of what we would consider to be a reasonable range of years to expect such a major

The Committee alleges that the New Haven has been able to sell more than $3 million in real estate each year and questions why other, unspecified non-operating properties could not be sold prior to receiving abandonment authority.[78] Many of New Haven's property sales have, however, resulted from the abandonment of branch lines authorized by the Commission. And if New Haven has substantial non-operating properties that could be sold, we question, as did the three-judge court,[79] why the trustees, with New Haven's history of cash deficits, did not sell them in the 1961–1968 period. These "non-operating" properties are primarily investments in affiliated companies or leased railroad lines,[80] and the record does not show whether any of them could be disposed of during the course of abandonment proceedings.

undertaking to require" (Exh. NHI–58, p. 9, App. 111c). See also testimony of Thompson, in Tr. 24368–24369, R. Doc. No. 111.

[78] Committee Brief, pp. 77–78. The Committee overstates the net sales of the past. The New Haven trustees have reported the following "Profits on sales of real estate" from 1965 through 1968:

1965	$1,922,518
1966	506,949
1967	1,897,837
1968	1,604,236

See reports for 1966 and 1968 of the trustees to Judge Anderson, filed March 17, 1967 (record page 4868) and May 29, 1969 (record page 7556) in the reorganization court.

[79] 305 F. Supp. at 1058; App. 415a.

[80] Exh. NHI–42, p. 8, Rec. Doc. No. 119. Certain Penn Central evidence, now relied on by the bondholders (*e.g.* see Manufacturers Brief, pp. 43–44) as allegedly showing these investments could be sold before the liquidation period began was expressly *excluded from the record* on motion of the bondholders and was not before the Commission when it issued the remand report. Exhs. R–32 and R–33, App. 351c–354c, were excluded at Tr. 28788, App. 381c.

Since New Haven's security investments are primarily in related operating companies,[81] it is quite one thing to argue that such investments could be sold after authority to abandon were granted, and yet another to assume that such investments could be disposed of in advance of such authority.

Preservation costs.—This item, amounting to $4,940,000, is the estimated cost of mothballing the New Haven fleet, assuming that the reorganization court would have required the trustees to cease running trains during the abandonment proceeding. The amount was estimated on the record by the New Haven trustee.[82] Contrary to the bondholders' contention that the trustee did not envision an eventual liquidation of properties,[83] counsel for the trustee referred to these costs at the prehearing conference as a "burial fund," that is, "how much money is required to preserve the estate from the day it ceases operation, whatever day that may be, until the day that the assets of the estate can properly be disposed of * * *"; and trustee Smith, who presented the fig-

[81] Section 77(c)(6) of the Bankruptcy Act requires the lessee of a line of railroad to operate it even if the lease is rejected, until "the lessee, with the approval of the judge, shall elect no longer to operate the leased line." If it would be "impracticable and contrary to the public interest for the lessor to operate the said line," it is "the duty of the lessee to continue operation" until the Commission authorizes abandonment.

[82] Exh. R–43, App. 374c–375c. Manufacturers argues it withdrew its objection to the exhibit only when the trustees' counsel described its limited purpose (Manufacturers' Brief, pp. 44–45). The record shows that the exhibit was admitted by the examiner for whatever purpose it might serve and that no limitation was placed on its admission (Tr. 28798, App. 382c).

[83] Tr. 28[illegible], R. Doc. No. 46.

ure, stated it would apply "even if the bulk of the property ends up being sold as scrap * * *."[84] The bondholders further argue that since there would be no further operations by the New Haven following the abandonment proceeding, New Haven would be under no obligation to preserve the system.[85] But even if we assume that New Haven would eventually be authorized to abandon its operations, in the meantime it could not "sell everything other than the 'line of railroad,'" as the Committee contends; its minimum statutory obligation would be to preserve its property until it could be ascertained whether all or a part should be abandoned, or whether a buyer would continue a part or all of the service.[86] Manufacturers further argues that New Haven would have had other income from Grand Central Terminal properties dur-

[84] Exh. R–1, p. 6, R. Doc. No. 50.

[85] Committee Brief, p. 81.

[86] In *Zirn* v. *Hanover Bank*, 215 F. 2d 63 (C.A. 2), relied upon by the Committee, certain equipment trustees and lessors of equipment of the New York, Ontario and Western obtained an order of the district court giving them possession of the equipment under the defaulted certificates and lease. The court of appeals affirmed the order on the grounds, unlike the Committee's argument, that no Commission approval is needed where cessation of operations for lack of equipment results "not from the volition of the railroad or its bankruptcy-trustee, but from the exercise of the supervening rights, here recognized by the Bankruptcy Act [under Section 77(j)], of third persons." 215 F. 2d at 69. In addition the Court noted that the railroad in fact had not ceased operation as a result of losing these locomotives, that other locomotives could be leased, and that the Court below might "soon direct the bankruptcy trustee to seek I.C.C. approval of abandonment of operation." 215 F. 2d at 69, note 7.

ing the one-year period. In fact, Penn Central was required to pay New Haven its share of this income for 1967 and 1968 under the existing agreement and not as a matter of payment for assets. Thus, Manufacturers is actually seeking a second payment of this income through the valuation process.[87]

Real estate taxes.—The final element of cost taken into account by the Commission in its estimate of the cost of an abandonment proceeding was $2,500,000 for one year of additional accruals of real estate taxes.[88] The bondholders' claim that these taxes would not have been paid falls with their invalid assumption that the sales of real estate could be accelerated so that only the first year's sales would be delayed. The trustees' appraiser Mason testified that, "the longer the period and the slower the liquidation, obviously the tax charges are going to be very much changed and presumably increased unless we have some change in the future taxation."[89]

3. The end result reached by the Commission is fair and equitable

Judge Friendly's opinion alternatively viewed the abandonment delay deduction in the context of the entire proceeding, and hence "in a practical, rather

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[87] See 304 F. Supp. at 806–807, App. 295a; 305 F. Supp. at 1061, App. 422a; 334 I.C.C. at 529, App. 223a.

[88] See Tr. 28814, R. Doc. No. 47.

[89] Tr. 23675–23676, R. Doc. No. 110.

than a theoretical frame."[90] In putting off the start of liquidation from January 1, 1967, to January 1, 1968, the Commission, as a practical matter selected "a fair date for shifting the heavy losses of NH's operation from the bondholders to PC." Such a judgment of the Commission is "peculiarly within its province" and is here reasonable in light of the more general factors that $5,000,000 was added to liquidation value on account of 1968 losses and actual take-over was ordered to occur at the end of 1968."[91]

Moreover, the bondholders' arguments, that certain properties could possibly be sold before an abandonment certificate was obtained, are "offset"[92] by three additional factors. First, as noted above, the Commission failed to deduct a further year's depreciation of some $3,000,000. The Committee argues[93] that, of that $3 million, $2.4 million relates to equipment, and no equipment would have remained for depreciation in 1967, during the course of the abandonment proceeding, since it would all have been repossessed. In fact, however, less than one quarter of the equipment would have been in danger of repossession,[94] even if the trustees would have allowed any repossession to occur.

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[90] 305 F. Supp. at 1057, App. 413a.

[91] 305 F. Supp. at 1057, App. 413a–414a.

[92] 305 F. Supp. at 1058, App. 415a–416a.

[94] The trustees' liquidation study showed that the obligations against some of the equipment exceeded the value of that equipment. In liquidation the trustees would disaffirm those obligations. Where the value exceeded the obligation, the trustees would protect the property against repossession and at-

As Manufacturers appears to recognize (Brief, p. 46), the Commission's estimate of one-year costs is understated by another factor, not even referred to by Judge Friendly, in that it fails to include any allowance for payment on any of the equipment obligations. Had the trustees sought an abandonment certificate before liquidation, they would have been required to expend substantial sums to safeguard the equipment from repossession, particularly that equipment having a market value in excess of outstanding obligations. In 1967, for example, the New Haven in fact made principal payments of $3,745,000 on matured equipment obligations and paid an additional $970,347 interest on equipment obligations.[95]

The second offset recognized by Judge Friendly is in the conservativeness of the Commission's estimate

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tempt to obtain the market value. The equipment obligations as of December 31, 1965, were, therefore divided, as follows:

	Affirmed (thousands)		Disaffirmed (thousands)	
	Liquidation value	Outstanding obligations	Liquidation value	Outstanding obligations
	(1)	(2)	(3)	(4)
Locomotives	$7,559	$6,868	$5,100	$13,638
Freight cars	8,750	660	340	692
Passenger cars	12,654	2,556	300	
Totals	28,963	10,084	8,740	14,330

See Exh. NHI-42, pp. 24-26; R. Doc. No. 119. The total of column 3 is only 23 percent of the sum of columns 1 and 3. At most therefore, there would have been a loss of $552,000 of depreciation, if the equipment in danger of repossession had been repossed on January 1, 1967 (or 23 percent of $2.4 million).

[95] Report of the trustees for 1967 to Judge Anderson, filed March 29, 1968, record pages 5675 and 5698 in the reorganization court.

that one year would suffice for an abandonment proceeding of such magnitude and importance. In this regard, the Commission stated that, "If the States or the Federal Government requested time to prepare studies, as we think they might, the time lapse between the filing of the application and the decision would approach 2 years."[96]

The third offset referred to by the three-judge court arises from the fact that the Commission might justifiably have adopted February 1, 1969, "as the possibly more logical starting date" for the beginning of liquidation. We have noted Manufacturers' statement that the courts would not have permitted New Haven to ignore the inclusion proceedings and liquidate. The three-judge court reasoned that abandonment and liquidation was the alternative to inclusion; the Commission might have selected the merger date (February 1, 1968), when "the right to inclusion accrued," as the date when an abandonment certificate would first have been sought, charging the estate with the administrative delay thereafter."[97]

Both in concept and in amount the Commission's estimate of New Haven's cost of seeking an abandonment certificate, consistent with the liquidation hypothesis, was reasonable and fair and should be sustained.

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[96] 334 I.C.C. at 59, App. 146a.

[97] 305 F. Supp. at 1058, n. 4, App. 415a–416a.

B. THE BULK SALE DISCOUNT IS AN APPROPRIATE MINIMUM REFLECTION OF RISKS WHICH WERE NOT TAKEN INTO ACCOUNT IN THE LAND APPRAISALS AND THE PRIOR DISCOUNTS

The trustees' land appraisals, which the Commission accepted, involved about 1,700 separate hypothetical sales over a period of at least six years. In several ways the appraisals were inexact even as approximations. For example, no effort was made by the Commission in the inclusion report to define the exact period required for marketing all these parcels; the Commission simply stated it was satisfied for the purposes of that report that most of the land could be sold in six years.[98] Moreover, although the testimony showed that a complete liquidation of the New Haven would have a drastic effect on the market for land in New England,[99] "no weight was given to the possible impact of termination of NH operations on the real estate market generally."[1] As with the cost of abandonment delay, it was unnecessary to make these refinements in the inclusion report, since Penn Central had agreed to pay an equivalent of the unrefined appraisals; but they did become pertinent in the different context on remand.

The three-judge court described the new testimony before the Commission on remand as follows:[2]

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[98] 331 I.C.C. at 663, App. 21a.

[99] Exh. NHI–44, pp. 11–12, App. 61c; Exh. NHI–97, App. 196c–198c; Exh. NHI–99, App. 199c–201c; Tr. 24330, App. 229c–230c.

[1] 331 I.C.C. at 677, App. 25a.

[2] 305 F. Supp. at 1058–1059, App. 416a.

At the hearing on remand PC adduced the testimony of Mr. Robert E. Simon, an experienced real estate operator. The burden of this was that the appraisals of the sale of land in some 1700 parcels over a six-year period, discounted merely by 6% did not reflect certain elements of risk in such an undertaking, notably the likelihood that the liquidation might take longer than estimated and the possibility of an economic downturn, even though the appraisals had substantially marked down land remaining unsold at the end of the fourth year. Mr. Simon thought the proper measure of the value of the land was the price it would command if sold immediately to someone who would assume these risks. Such a person, he testified, would finance 75% of the purchase price by loans, which could not be obtained at less than 9% and would demand a 15% profit on his own investment for his entrepreneurial contributions and for undergoing the downside risks, despite the possibility that even higher prices might be realized. [[3]] Combining these figures to reach a composite of 10.5%, the Commission concluded that the land prices should be discounted by 4.5%, or $6.695 million, above the 6% previously deducted.

The Commission's rationale for the deduction was two-fold. First it agreed with Penn Central that such

[3] Exh. R–29; App. 346c–350c. A witness for the bondholders testified that a 6 percent discount was sufficient. Exh. R–19, App. 338c–340c. As the three-judge court held, the Commission was not bound to accept the opinion of the bondholder witness, 305 F. Supp. at 1059, App. 418a. And see *Market Street R. Co.* v. *Railroad Comm'n of California*, 324 U.S. 548, 560–561 (1945); *Dayton P. & L. Co.* v. *Public Utilities Comm'n. of Ohio*, 292 U.S. 290, 299 (1934).

a deduction gave the bondholders "the full economic equivalent of the liquidation value of the assets" in that such a deduction "reflects a market appraisal of the risks that the estate avoids, and the bulk buyer assumes."[4] Second, going beyond that position, in findings that were completely independent, the Commission further stated that in an appropriate case it could "compel the bulk sale and the bulk sale discount as a condition of an abandonment certificate, and, therefore, as a reduction of the present price," in order to attract a bulk buyer for continued operation of the railroad on the basis of a fair market price and to preserve the railroad as a going concern.[5]

Without deciding the validity of the Commission's second position, the majority of the three-judge court sustained the first position. The court read the Commission's statement of its first position "as saying that the Commission deducted the discount as a proper measure of risks not taken into account by the appraisals and the discount to present value."[6] The court analogized the deduction to a premium for underwriting against the risk of a market downturn,

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[4] 334 I.C.C. at 61, App. 148a. Later in the report the Commission grouped the bulk sale deduction with the cost of an abandonment proceeding (a total of $22,081,000) and found both together, "recognize [d], without conceding, NH's right to abandon and liquidate the estate." 334 I.C.C. at 63, App. 150a.

[5] *Ibid.* The Commission nevertheless accepted the minimum deduction proposed by witness Simon, recognizing it as probably an understatement. See 334 I.C.C. at 62–63, App. 149a–150a.

[6] 305 F. Supp. at 1059, App. 417a. The court at the same time expressed its "gravest doubt concerning the legal premise" underlying the second position.

which in the present case would be prudent in view of the risks entailed over a long liquidation period of six years. The court noted in particular that the basic appraisals had given "no effect to the serious adverse economic consequences from discontinuance of NH's operations."[7]

The reorganization court, on the other hand, refused to accept the discount because there was no evidence of the existence of a market for all of the New Haven properties in bulk.[8] As noted, however, the bulk sale discount did not depend upon the existence of a buyer, since it merely quantified the risks of a piecemeal liquidation which had not already been accounted for. The reorganization court further assumed, as the bondholders argue, that a deduction of $8,000,000 made by one of the appraisers for the trustees in order to keep the liquidation within a six-year period had already provided for "all" the risks of marketing within a six-year period.[9] But the record does not support the court's assumption.

First, the witness (Frank A. Mason) who presented the $8,000,000 figure explained that it related solely to certain specific acres of New Haven lands;[10] he did

[7] 305 F. Supp. at 1059, App. 418a. An appraiser for the trustees testified that industrial land values in New York would decline 10 percent in absence of rail service. Tr. 28849, App. 385c. See also p. 52 and note 99, *supra*.

[8] 304 F. Supp. at 805, App. 292a–293a.

[9] 304 F. Supp. at 805–806, App. 293a. The Committee ignores this holding and seeks to use the $8 million figure as an offset against the abandonment cost (Committee Brief, p. 80).

[10] He applied a discount to the appraised values of New Haven's many long, narrow rights of way outside urban areas, which in his opinion would remain unsold at the end of the fourth year of liquidation (Tr. 23784, R. Doc. No. 110).

not testify that it represented an overall discount for all the risks of a six-year marketing program, and the trustees' study never reached the question of pricing out the overall risks. Indeed, other evidence tends to indicate that New Haven's undergoing all those risks would have been much more costly than $8,000,000. Thus, the trustees' witness who presented the 10-year liquidation study (B. W. Thompson) testified that even after taking more time to liquidate the property he would apply a total discount of over $21.3 million to the property values,[11] or $13,300,000 more than Mason. Mr. Thompson did not relate his discount to the difficulty of disposing of any particular parcels.

Second, apparently for the above reasons, witness Mason himself saw no conflict between his $8,000,000 end-of-the-period adjustment and an increase in the discount to present worth (to cover the risk that the dollar proceeds might not be achieved). Although he admittedly took into account in his appraisals the matters of time and the certainty of the dollar amounts being achieved,[12] he responded in the following colloquy:[13]

> Q. * * * Mr. Gordon conceded that if one were after present value, you would have to

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[11] Tr. 24373, R. Doc. No. 111. He testified that several "cats-and-dogs" would appear in the tenth year, or $28,425,000 of unspecified property, which he would discount 75 percent. Exh. NHI-61, R. Doc. No. 120; and Tr. 23675, 23683, R. Doc. No. 110. Counsel for New Haven described the 10-year study as "the considered judgment of a man who spent his lifetime selling New Haven real estate." Tr. 24406, R. Doc. No. 111.

[12] Tr. 23797-98, R. Doc. No. 110.

[13] Tr. 23798, R. Doc. No. 110.

apply a discounting factor to the estimated proceeds to be received during this extended liquidation period and as I recall it, Mr. Gordon used a factor of 6 percent in his example that he gave of a discounting. Do you recall that?

A. Yes, I do.

Q. In your judgment would the 6 percent be on the low side?

A. Well, let me say I have not made such an analysis. My opinion is that *it would be on the low side, yes.* [Emphasis added].

Finally, the weight to be accorded the $8,000,000 figure was clearly for the Commission, rather than the reorganization court, to determine. This is particularly true in view of the fact that witness Simon testified with full awareness that certain properties had already been substantially discounted in the last years of the liquidation period by witness Mason.[14] In apparently deciding to give little or no weight to the Simon testimony, the reorganization court impermissibly assumed the Commission's function.

Chase argues that the Commission did not purport to measure its deduction for the bulk sale "by the degree of any alleged risk," but rather based the deduction on the testimony of Simon who did not know what precise risks were covered or were not

[14] In Exh. R-29, App. 348c, Simon stated that one of his assumptions was, "that, in recognition of the difficulty of selling certain undesirable parcels, and the advantages of bringing the liquidation period to an end, the appraised value of the land estimated to be unsold at the end of the fourth year has been marked down substantially, for purposes of estimating the gross proceeds of the fifth and sixth year of the marketing period."

covered by the appraisals.[15] Simon's assumptions adequately reflected the prior liquidation study. His testimony assumed the per-parcel appraisals had been carefully and competently prepared, that the value of land at the end of the fourth year had been marked down in recognition of the difficulty of selling certain undesirable parcels, and that the proceeds had been discounted at an annual rate of six percent to their current worth.[16] In his opinion the six percent discount was not enough as a general matter, since "there are always risks of unforeseen developments which frustrate marketing plans or depress values," [17] including in particular the uncertainty as to the precise time period for marketing the real estate.[18] The Commission adopted Simon's estimate as to the deduction that the market would make for the unpriced risks of a six-year liquidation of the New Haven, based upon the principles that 75 percent of the price at most could be financed by securities bearing at least a 9 percent interest rate, and that the remainder would command at least a fifteen percent return. As the Commission stated, the witness' evidence involved "minimum financial terms, and not those terms that correspond to the risks of a 6-year liquidation of the NH," [19] and accordingly his discount "reflects the bare

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[15] Chase Brief, p. 68; and see Committee Brief, p. 90; Manufacturers Brief, p. 53.

[16] Exh. R–29, pp. 3–4, App. 347c–348c.

[17] Exh. R–29, p. 7, App. 350c.

[18] Exh. R–29, p. 6, App. 349c.

[19] 334 I.C.C. at 62–63, App. 149a–150a. The Commission further stated that the discount was on the low side, since it had

minimum discount of that type."[20] In short, the Commission recognized that the degree of the risks involved in a 6-year liquidation of the New Haven would support a greater deduction than Simon advocated.

II. THE REORGANIZATION COURT IMPROPERLY SUBSTITUTED ITS OWN INDEPENDENT JUDGMENT FOR THAT OF THE COMMISSION IN VALUING REAL ESTATE AND DISCOUNTING FUTURE PROCEEDS TO PRESENT WORTH

A. THE VALUATION OF THE HARLEM RIVER AND OAK POINT YARDS

The Harlem River and Oak Point Yards comprise about 160 acres of freight yards in the Bronx area of New York City. The parties presented five different appraisals of these yards to the Commission, which accepted the trustees' appraisal of $18.1 million in the inclusion report as "the most accurate" of the appraisals.[21]

In the first round of judicial review, the three-judge court reversed the Commission for lack of sufficient explanation as to why it had rejected the higher appraisal of the trustees. The court stated it was unclear why there was a difference in the trustees' two appraisals; however, if the higher valuation had assumed the properties would continue to be used as

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been limited to land proceeds although it would seem to apply in principle to the sale of all the other assets in bulk rather than item by item. The Commission added that the discount would be greater if it had not employed the creditors' schedule of receipts.

[20] 334 I.C.C. at 62–63, App. 149a–150a.

[21] 331 I.C.C. at 668, App. 26a; 289 F. Supp. at 433, App. 344a.

railroad yards, "the Commission would have been justified in rejecting it as a guide to the yards' liquidation value." [22] The reorganization court would have sustained the Commission's valuation of these yards, and accordingly disagreed with the three-judge court. It stated, "While a clarification of these matters is desirable, it appears to this court on the present record that there was substantial evidence to support the Commission's valuation and not enough to show that it was unfair or inequitable." [23]

On remand, the trustees' witness (Arthur McCann) was cross-examined on the premises underlying his two appraisals. He testified that his first and higher appraisal would apply only if the *same services* New Haven provided would continue to be provided upon New Haven's liquidation.[24] The Commission accordingly found that the first and higher value should be rejected because, on the record before it, "it is extremely doubtful that railroad service would continue to the Harlem River and Oak Point Yards if NH's system were liquidated." [25] The main receiver of shipments is at Hunts Point where perishable commodities, which are inherently unprofitable to the railroads,[26] are marketed. Penn Central "would not be legally obligated to perform switching service beyond its own line or extend its line to serve NH's industries

[22] 289 F. Supp. at 434, App. 345a.
[23] 289 F. Supp. at 464, App. 254a.
[24] Tr. 28863–28865; App. 392c–393c.
[25] 334 I.C.C. at 44, App. 131a.
[26] 334 I.C.C. at 45–46, App. 132a–133a.

if the present joint rates were terminated by NH's liquidation." [27] The report continues: [28]

> The record does not support any finding of substantial need for Penn Central service that would justify the construction by that carrier of the trackage necessary to connect Harlem River and Oak Point yards and the latter yard and Hunts Point, if NH were to be liquidated. Nor is there any evidence that the expenditures necessary to correct clearance deficiencies on the Port Morris branch would be warranted by the revenues resulting therefrom. On this record, and the assumption of NH's liquidation and the dismantling of its system, Penn Central would not serve, and could not be compelled to serve, the Harlem River or Oak Point industries, or the Hunts Point Market.

The Commission added it is "unlikely that rail service by a carrier other than Penn Central would be performed in the yards if NH were liquidated." [29]

On reviewing these findings, the reorganization court disagreed with the Commission's assessment of the yards' use and reversed its prior acceptance of the lower valuation.[30] It held that since Penn Central has a track connecting with the New Haven right-of-way at a point over two miles away from the Hunts Point

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[27] 334 I.C.C. at 45; App. 132a.
[28] 334 I.C.C. at 47, App. 134a.
[29] *Ibid.*
[30] 304 F. Supp. at 807–808; App. 295a–297a.

Wholesale Market erected by the City of New York,"[31] the City would take steps to preserve that connection if New Haven were in fact liquidated. And, if that occurred, "it is certainly unlikely that Penn Central could then deny a spur track connection to industrial owners and users of the property in question."[32]

As Judge Friendly noted, acceptance of the findings of the reorganization court would not necessarily require adoption of the higher appraisal. Service to Hunts Point would not necessarily bring the *same* services to the yards as New Haven provided prior to liquidation." Moreover, the "Commission's evaluation of the probable scope of future rail service to these properties in the event of liquidation of NH lies in an area peculiarly within its expertise," and accordingly a court should "decline to disturb it."[34]

The bondholders complain that the Commission improperly relied on evidence outside the record to determine whether the perishable traffic was profitable to Penn Central, citing the Commission's reference to a cost study prepared by Commission staff from reported figures in 1965.[35] The Commission in fact relied upon the substantial testimony of a Penn Central witness that the preponderance of

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[31] The reorganization court never answered the question who would buy the necessary trackage within the yards to connect up the Penn Central tracks to the Hunts Point area. The relative location of Penn Central's track to Hunts Point is shown on the map attached at App. 511c.

[32] 304 F. Supp. at 807–808, App. 297a.

[33] 305 F. Supp. at 1061, App. 423a.

[34] *Ibid.*

[35] 334 I.C.C. at 46, App. 133a.

the traffic to these yards was perishable and not profitable to the railroads and that therefore he would not recommend that Penn Central make an investment to obtain the traffic.[36] The Commission stated this testimony was "supported" by the railroads' periodic reports, which "year after year indicate that this traffic is handled at a loss."[37] The table set forth in the remand report was based on the most recent data on the principal perishable traffic then available to the Commission.

The record without the table fully supported the Commission's valuation of the yards. As for the reference to the table, "[t]he most that can be said is that the Commission in making its predictive findings went outside of the record to verify its judgment by reference to actual traffic [and cost] figures * * *. The process of keeping informed as to regulated utilities is a continuous matter with commissions." An "incidental reference" to the data supplied by the regulated carriers does not constitute a want of due process. *Market Street R. Co.* v. *Railroad Commission of California,* 324 U.S. 548, 561–562.[38]

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[36] Tr. 29420–21, 29461, App. 397c–398c, 403c.

[37] 334 I.C.C. at 45, App. 132a.

[38] "[T]he mere fact that the determining body has looked beyond the record proper does not invalidate its action unless substantial prejudice is shown to result." *United States* v. *Pierce Auto Lines,* 327 U.S. 515, 530. The present case is totally unlike *Ohio Bell Tel. Co.* v. *Comm'n,* 301 U.S. 292, 300–301, and similar cases cited by the bondholders, where values of land, labor, buildings, equipment, and other matters outside the data constantly filed with the agency, were noticed and relied on.

B. THE DISCOUNT OF FUTURE LIQUIDATION PROCEEDS TO PRESENT WORTH

After the reorganization court had entered its opinion, and on settlement of its decree, counsel for the first mortgage bondholders sent Judge Anderson a letter presenting for the first time in the proceeding attacks upon the trustees' discount to present worth, which the inclusion report had adopted.[39] The bondholders argued that the trustees' witness Gordon omitted over $47 million in receipts, which should have been discounted, and included $26 million in receipts which should not have been discounted. Whether these alleged errors made any difference in the end result depended entirely on the assumptions as to when the affected proceeds would be received. The bondholders assumed in their letter that most of the $47 million of proceeds would be received early in the liquidation period, and most of the $26 million late in the liquidation period, for an alleged net discrepancy in the discount of $2.4 million. Different assumptions would have removed the discrepancy, but the question was never presented to the Commission for its resolution.

Although the bondholders' argument had never been presented to the Commission or briefed and argued before any court, the reorganization court, nevertheless, accepted the argument (and its necessary assumptions) in the formulation of the decree, and without further analysis concluded in its order,[40]

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[39] Letter of June 17, 1969, App. 502c–510c.

[40] 304 F. Supp. at 1137–1138, App. 318a.

> The sum of $2,415,899 should be added to liquidation value inasmuch as it was improperly deducted in applying the discount to present value found by the Commission * * *

When the bondholders sent a similar letter to the three-judge court on settlement of its decree, the majority rejected the proffer of a new analysis as not "appropriately before us on settlement of the decree." [41] The reorganization court should similarly have rejected the bondholders' late argument, which had been waived by the failure to present it to the Commission. *United States* v. *L. A. Tucker Truck Lines*, 344 U.S. 33, 36–38; *Unemployment Commission* v. *Aragon*, 329 U.S. 143, 155.

III. THE ISSUES ON WHICH THE LOWER COURTS AGREE RAISE NO SUBSTANTIAL QUESTIONS

A. NEW HAVEN HAS NO LAWFUL INTEREST IN INCOME FROM GRAND CENTRAL TERMINAL PROPERTIES WHICH PAYS ITS FORMER SHARE OF TERMINAL EXPENSES

The New Haven bondholders claim upwards of $70 million from Penn Central on the basis of an alleged contractual right of the New Haven to obtain an equal share in all the income from the Grand Central Terminal properties without any deduction for the payment

[41] App. 445a. Manufacturers illogically argues (Brief, pp. 74, 77–78) that Judge Friendly preserved the merits of this point for resolution by this Court, as if the three-judge court would have held the point was not "appropriately before us on settlement of the decree" but would be appropriately before the Supreme Court on appeal.

of terminal expenses.[42] This claim, rejected by both of the lower courts, as well as a special master in the reorganization court, is without merit.

The New Haven's rights and obligations with respect to these properties prior to inclusion derived from a series of agreements between New Haven and the former New York Central Railroad (now Penn Central). The two basic agreements are dated 1907 and 1913 (App. 151c–174c and 175c–179c, respectively).

The agreement of 1907 recites that it had become necessary to rebuild the station, including its yards and tracks, in order to provide facilities for the proper management and conduct of the two railroads (App. 152c). Central undertook to buy the necessary land and rights of way, and "in consideration of the rents hereinafter reserved to be paid by the New Haven Company * * * demised, let and leased * * * the use, in common with the Central Company * * * of the said Railroad Terminal" (App. 153c–154c). New Haven agreed to pay interest in connection with the demolition of the old station and the construction of the new one (App. 154c) and a proportion of expenses of the terminal based on its use thereof as reflected in its relative number of car entrances into the terminal (App. 156c–157c).[43]

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[42] The properties include several hotels and office buildings in an area between 42d Street on the south, 60th Street on the north, Madison Avenue on the west, and Lexington Avenue on the east in New York City. Exh. R–2, Agreement, p. 3, R. Doc. No. 50. The affected land and buildings are listed by address in Exh. NHI–1, Appendix A thereto; App. 26c.

[43] In recent years, this usage became 41 percent of the total.

The 1913 agreement between the same parties was styled a "Supplemental Agreement" (App. 176c). It recited that New Haven's right to use the terminal included "the right * * * to join with the Central Company * * * in the construction, holding, maintenance and leasing of buildings * * * upon the land included within the Railroad Terminal" (App. 177c). New Haven would obtain "an undivided interest" in the buildings so jointly constructed until reimbursed for moneys contributed, at which time "such undivided interest * * * shall cease" (App. 178c). The supplement further provided that all building rentals shall be "credited to the fixed charges or to the cost of maintenance and operation of the Railroad Terminal under the provisions of Paragraph 14 of this agreement" (App. 178c). The referred-to Paragraph 14 of the 1907 agreement provided that, "all rentals not belonging exclusively to either Company, shall be credited to the fixed charges or to the cost of maintenance and operation of the said Railroad Terminal * * *" (App. 165c)."

"A dispute involving these contract terms came before this Court in *Interstate Commerce Commission* v. *New York, N.H. & H. R.R.*, 287 U.S. 178, on the question whether these properties must be included in New Haven's rate base. Mr. Justice Cardozo writing for the Court held that New Haven had a "right to the use of the terminal" (at 186), with value in its "use," as distinguished from being an "owner of the fee" (at 195).

Based upon an opinion by former counsel for the New Haven,[45] the trustees' appraisal had given very little liquidation value to New Haven's interest in the terminal properties.[46] In the inclusion report the Commission assigned a value to New Haven's interest of $13 million without attempting to define it,[47] and a major issue litigated by the parties during the first round of judicial review was the nature of New Haven's legal interest.

In a report of June 17, 1968, the Honorable John Van Voorhis, a retired judge of the New York Court of Appeals appointed special master by the reorganization court, ruled that in his opinion "there was a joint venture or partnership here of some kind" (App. 274c), and "by mutual agreement these revenues from all of the Grand Central Terminal properties were pooled to apply on the fixed charges and maintenance and operational costs of the Terminal" (App. 275c). He concluded that "It was not contemplated that if either railroad discontinued passenger trains into Grand Central the other would be saddled with the entire expense of a terminal larger than either railroad needed without being credited with the entire revenues from the Grand Central Terminal properties to the extent they were required to meet expenditures" (App. 277c, and see App. 286c). Nor

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[45] Exh. NHI-5, App. 27c. The firm had represented New Haven in the *Biltmore* case (*New York Central R. Co.* v. *New York, N.H. & H.R. Co.*, 13 A.D. 2d 309, 216 N.Y.S. 2d 928 (1st Dept.), affirmed, 11 N.Y. 2d 1077; see Exh. NHI-1, p. 65, R. Doc. No. 118.

[46] Tr. 27486, App. 237c.

[47] 331 I.C.C. at 679–84, App. 37a–42a.

was it intended that the excess belong entirely to Central, as Penn Central argued (App. 278c); 50 percent of the excess belongs to New Haven (App. 280c).

The three-judge court agreed with the special master in its review of the inclusion report.[48] The reorganization court similarly commended the report of the special master to the Commission on remand, and in addition asked the Commission to find "what value, if any, attaches" to New Haven's right to free use of the terminal.[49]

On remand the Commission equated the "free-use" argument to the bondholders' prior attempt to claim one-half interest in the terminal income before terminal expenses. In addition, the Commission foresaw no potential buyer for New Haven's alleged interest in operating into the terminal upon liquidation. New Haven's only lawful interest, therefore, "is in excess income."[50] As noted, both courts agreed with the Commission when they reviewed the remand report.

The bondholders' primary argument here, that the Commission must weigh the benefit to Penn Central of obtaining sole title to the Grand Central properties as the result of the merger and inclusion, has been consistently rejected by the lower courts. The argument seeks to circumvent the liquidation hypothesis and create additional value out of an alleged benefit of the transfer to Penn Central.

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[48] 289 F. Supp. at 431; App. 339a.
[49] 289 F. Supp. at 463, App. 252a-253a.
[50] 334 I.C.C. at 32, App. 119a.

The bondholders further hypothesize that, if New Haven had gone into liquidation, there was a possible condemnation of New Haven's West End commuter service by the States of New York and Connecticut, which allegedly would have to pay for use of the terminal. The three-judge court considered the hypothesis too speculative to form a basis for valuation.[51] Moreover, the hypothesis was contrary to the findings of the Commission that the States would not need to pay for entrance into the terminal.[52] It was further contrary to the anti-assignment clauses of the 1907 agreement.[53]

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[51] 289 F. Supp. at 431; App. 340a.

[52] The Commission stated that New York would have sufficient bargaining power, for example, to "offset the annual tax forgiveness against the current operating expenses of the terminal," unless it received free use of the terminal. 334 I.C.C. at 32; App. 119a. The press has reported a recent agreement between New York and Penn Central under which the State would receive free use and pay a portion of the tolls (see Manufacturers Brief, p. 59 footnote).

[53] App. 161c, 170c–171c. Although, as Chase contends (Brief, pp. 76–79), anti-assignment clauses sometimes do not apply to an assignment by operation of law, the 1907 agreement differs from the ordinary lease. New Haven's former counsel had described these differences to the trustees as follows (App. 43c–44c):

"This agreement, as is made clear by the Biltmore litigation, is much more than a mere lease; it constituted the parties as partners in a joint venture, each sharing equality of control over the development of the Terminal area. Because it is generally recognized that a partner's interest in the partnership cannot be assigned without the consent of the other partners, there is a real possibility that a court, invoking this rule of partnership law by analogy, would more strictly apply the covenant

The bondholders' right to Grand Central income can rise no higher than a contract claim based on the 1907 agreement as supplemented in 1913. The special master and the lower courts have construed that agreement as creating contract rights in the New Haven, surviving New Haven's liquidation and its abandonment of passenger trains into Grand Central, limited to 50 percent of excess income from the terminal properties after payment of all terminal expenses. While there is much that could be said in favor of a construction of that agreement which would give no value to New Haven's interest, we submit the construction given by the special master and by both lower courts—which was the basis for the Commission's valuation—is reasonable and should be sustained.

B. NEW HAVEN HAD NO COMPENSABLE "GOING CONCERN VALUE" ON THE VALUATION DATE UNDER THE LIQUIDATION HYPOTHESIS

The bondholders continue to argue an alleged "going concern value" of $55 million in the deficit-ridden

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against assignment than it would in a case involving an ordinary lease.

"A further difference between the 1907 Agreement and an ordinary lease is the covenant contained in paragraph 20 that neither of the parties will assign the contract or any interest thereunder to a railroad company which may be a rival or competitor to the other party. The usual covenant against assignment serves no purpose other than preserving to the lessor his right to choose his tenant. The covenant contained in paragraph 20, however, embodies the very practical and probably more important consideration that one should not have foisted upon him a partner not of his own choosing who also happens to be a competitor."

New Haven.[54] Both courts sustained the Commission's refusal to add any such sum to the valuation of the New Haven on a liquidation basis, and that common decision should be sustained.

The Commission considered the bondholder estimate of New Haven's "going concern value" to be greatly exaggerated even as an exercise in mathematics. The Commission would assign a value to these intangibles no greater than 10 percent of the bondholder estimate.[55] But the addition of even this reduced amount in the value of the New Haven properties, as of the valuation date, would be completely inconsistent with a liquidation value approach.[56] The three-judge court sustained the Commission's finding, stating, "'there is no 'going concern value' in a deficit ridden railroad being liquidated as real estate or

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[54] Manufacturers Brief, pp. 79–83; Committee Brief, pp. 114–118. "Going concern value" includes such historical costs, as engineering, the hiring and training of employees, and the creation of accounting systems and management teams. See 331 I.C.C. at 685, App. 43a.

[55] The bondholder estimate was made "without regard to the probability that NH in its present form would never be built today." 331 I.C.C. at 685, App. 43a.

[56] 331 I.C.C. at 686–87, App. 44a–45a. Neither the Commission nor the lower courts treated going concern value as merely an alternative method of valuation, as Manufacturers asserts (Brief, p. 79). These tribunals specifically addressed themselves to whether New Haven was entitled to liquidation value and " additional amounts" for going concern value (331 I.C.C. at 686, App. 44a; 289 F. Supp. at 435, App. 347a).

scrap; the bondholders cannot have it both ways."[57] The reorganization court agreed.[58]

Plainly the bondholders cannot obtain value out of the liquidation hypothesis, and then switch hypotheses to obtain a higher value as to one element. If the Commission were to follow a going concern approach to New Haven's value, quite obviously its findings of value would differ greatly from those it has made on the liquidation hypothesis.[59]

Manufacturers asserts that the failure to award any going concern value violated the law of New York State. Federal law, of course, applied to the proceedings before the Commission; but in any event there is no inconsistency with New York law. The *Fifth Avenue Coach* case,[60] relied on by Manufacturers, concerned a bus company which (unlike New Haven) had a substantial going concern value; its highest and best use was not for scrap. In the *PATH* case,[61]

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[57] 289 F. Supp. at 435, App. 347a. Even as a matter of condemnation law, "federal law does not require payment of going concern value in condemnation when liquidation constitutes a property's 'highest and best' use since the assets have substantial value for that purpose but no earning power." 289 F. Supp. at 435, App. 348a.

[58] 289 F. Supp. at 455, App. 239a–240a.

[59] The Commission flatly stated, "with no pretence at mathematical precision * * * the total value of the NH sold as a going concern is less than its liquidation value" (331 I.C.C. at 687, App. 45a).

[60] *In the Matter of the City of New York (Fifth Avenue Coach Lines, Inc.)*, 18 N.Y. 2d 212, 273 N.Y.S. 2d 52; 22 N.Y. 2d 613, 294 N.Y.S 2d 502.

[61] *Port Authority Trans-Hudson Corp.* v. *Hudson Rapid Tubes Corp.*, 20 N.Y. 2d 457, 285 N.Y.S. 2d 24, 231 N.E. 2d 784, certiorari denied, 390 U.S. 1002.

also cited by Manufacturers, the Appellate Division reasoned that there were no prospective purchasers on the open market for the tunnel that made up most of the railroad's property and hence gave the tunnel a zero liquidation value. The New York Court of Appeals reversed, distinguishing the ordinary case (such as the present one) by stating that "the rule which was applied by the Appellate Division is one of general acceptance * * * and achieves a reasonable and just result in most cases." But when fair market value "would result in manifest injustice * * * courts have fashioned and applied other standards" (285 N.Y. S. 2d 30–31). The Court thereupon fashioned a special standard which in its view would avoid a manifestly unjust end result. The total valuation of the New Haven, unlike the zero valuation given the tunnels in *PATH*, is manifestly fair and just. The three-judge court correctly stated "it is at least doubtful that the rule [in *PATH*] would be applied in other situations in which the condemnee's equities were not so compelling." [82]

C. THE COMMISSION FAIRLY AND EQUITABLY VALUED THE PENN CENTRAL COMMON STOCK

As the brief of Chase explains (pp. 91–92), the New Haven trustees insisted, and Penn Central agreed, that the bulk of the consideration to the New Haven estate should be in the form of Penn Central common stock; the purpose here was to permit the New Haven creditors "to participate in the benefits of the merger." Consequently, the purchase agreement and the Commission's order provided that Penn Central

[82] 289 F. Supp. at 435; App. 348a.

should deliver 950,000 shares of Penn Central common stock, which the Commission valued at $87.50 per share or $83,125,000.

The first mortgage bondholders primarily argue that they are constitutionally entitled to value the Penn Central stock on the basis of its recent market value. Their position is inconsistent with the premise under which the stock forms the bulk of the consideration. If, as the Commission has found, the Penn Central stock has a current intrinsic value greater than its current market value, and if the estate will realize the intrinsic value, then a windfall would result from reliance on current market value to determine the number of shares that Penn Central must deliver.

This Court has held under Section 77 that a class of creditors is not constitutionally deprived of value if the securities it receives are the "equitable equivalent" of those it loses as a result of reorganization. Such an exchange "requires a comparison of the new securities allotted to him [the creditor] with the old securities which he exchanges to determine whether the new are the equitable equivalent of the old"; and "that determination cannot be made by the use of any mathematical formula." Such valuations are primarily matters of "informed judgment." *Group of Investors* v. *Milwaukee R. Co.*, 318 U.S. 523, 566. Similarly under Section 5 the Commission may consider the "present intrinsic value" of the exchanged shares; the present intrinsic value, as well as market value, may indicate that the bondholders were given "the fair economic equivalent of what they already held." *Schwabacher* v. *United States*, 334 U.S. 182, 188, 200 (1948).

We submit that the evidence before the Commission supports the finding that a value of $87.50 per share (or $83.1 million for 950,000 shares) reflects the inherent qualities of the Penn Central stock,[63] and that the stock on December 31, 1966, was the equitable equivalent of $83.1 million of New Haven liquidation value. This is so especially in light of the underwriting arrangements adopted by the Commission.

1. The valuation properly reflects prospective earnings of Penn Central discounted to present worth

The Commission found that once the anticipated merger savings of $81 million were being realized by Penn Central each year, the value of the stock (on the basis of a capitalization rate of 8 percent) would be approximately $100 per share.[64] The capitalized value of the latest earning of record was about $68 per share. The Commission effectively discounted the shares to a present worth of $87.50 per share.[65] The Commission further noted that "the trend in the market price of Penn stock is up."[66] The past market price of the surviving company "has trended upward since 1962 from a mean price of $14.50 per

[63] See 331 I.C.C. at 698; App. 56a.

[64] The Commission used the 8 percent capitalization rate both to find stock value (331 I.C.C. at 689, App. 47a) and to value New Haven's interest in the Grand Central properties (334 I.C.C. at 36, App. 126a).

[65] 331 I.C.C. at 689–90; App. 47a–48a.

[66] 331 I.C.C. at 689; App. 47a.

share in that year to a mean price of almost $57.11 for 1966." [67]

Besides the prospective earnings of Penn Central, the record contained the testimony of New Haven trustee Kirk, who testified that a fair current valuation of the stock was $87.50 per share. He concurred in the unrebutted analysis of another financial analyst (Roehl) employed by the trustees, who testified that the prospective market value of the Penn Central stock was in the range of $144 to $196 per share.[68] The bondholders' only witness on stock values was presented nearly two years later in the remanded proceeding. The Commission gave little weight to this testimony, stating that the witness was "unfamiliar with Penn Central's operating and financial plans and condition; gave undue weight to extraordinary expenses of the past; and generally neglected the future prospects of the company." [69]

The lower courts essentially agreed that, in the words of the three-judge court, spot fluctuations in the market price of Penn Central shares should not be controlling, "especially when, as here, there are reasonable explanations for them, such as the unanticipated difficulties in working out the operating details of the merger and the prospect of PC's having to shoulder NH losses at an earlier date and in larger amounts than had been anticipated." [70]

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[67] 331 I.C.C. at 698; App. 56a. See also Exh. NHI–72, p. 18.
[68] Exh. NHI–65, p. 23; App. 149c.
[69] 334 I.C.C. at 68; App. 155a.
[70] 305 F. Supp. at 1064; App. 430a.

On the other hand, the uncertainties surrounding the valuation of the Penn Central stock were no more serious than those surrounding the valuation of the New Haven properties. As Judge Friendly aptly stated, all future values are at best an approximation, leaving in each case a "reasonable margin of fluctuation and uncertainty," appropriately adding that "[s]uch considerations are peculiarly applicable to a determination so hypothetical as the liquidation value of the New Haven".[71] In like vein the court properly held that "a reasonable time should thus be accorded to determine what the real value of PC stock is."[72]

2. The underwriting requirement provides unique assurance that the Commission's valuation of the stock will be realized by the New Haven estate

Following the entry of the opinions by the lower courts on review of the remand report, and before entry of any decree in either court, the Commission issued its fifth supplemental report, which *inter alia* adopted an underwriting requirement in principle.[73] Under this requirement, first proposed by Judge Anderson in his decision of May 28, 1969, and concurred

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[71] 305 F. Supp. at 1053, App. 404a, quoting from *Dayton P. & L. Co.* v. *Public Utilities Comm'n of Ohio* 292 U.S. 290, 310. And see 334 I.C.C. at 54, App. 141a; and Exh. NHI–65, p. 14, R. Doc. No. 120, where trustee Kirk testified: "we discussed among ourselves the essential unreliability of all liquidation estimates. The proof of the liquidation pudding unfortunately only comes in the eating. While every business is faced with the likelihood of a substantial unpredictable discount upon announcement of impending liquidation, a railroad has unique characteristics which make achievement of liquidation value estimates particularly conjectural."

[72] 305 F. Supp. at 1064; App. 430a.

[73] 334 I.C.C. 528 at 532; App. 222a at 226a.

in by the three-judge court,[74] Penn Central would be called upon to make up in cash the difference between the market price of Penn Central stock in 1978 and $87.50 per share, unless before that time the market price had attained $87.50 per share for a five-day period.[75]

No bondholder really questions the ability of the New Haven, when reorganized as an investment company, to last the eight years until it fully realizes on the Penn Central stock. The record shows that the reorganization plan provides enough cash to service the debt structure of the reorganized company with room to spare. The cash actually provided the estate is a further assurance that the intrinsic value will be fully realized.[76]

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[74] 304 F. Supp. at 809–810; App. 299a–301a. 305 F. Supp. 1064–1065; App. 429a–430a.

[75] Certain technical differences between the formulas espoused by Judge Friendly and by Judge Anderson, must yet be resolved; we suggest that the Commission is the proper forum for writing the final draft of the requirement. See 334 I.C.C. at 532; App. 226a. The Commission pointed to the need for greater specificity in the underwriting formula concerning what price should govern during the 5-day test period, what should be the effect on the formula of a stock split or stock dividend, and other contingencies. Judge Friendly incorporated several suggestions of the parties in his formulation of the requirement (App. 449a–452a), which the reorganization court omitted (304 F. Supp. at 1138, App. 318a–319a), but apparently referred to the Commission (see 304 F. Supp. at 1139, para. C; App. 322a).

[76] In addition to the cash provided under the plan, the Commission on its own motion relieved the New Haven of an obligation to expend $2.3 million in connection with the reorganization of the Boston and Providence Railroad. (334 I.C.C. at 50, 52, 65; App. 137a, 139a, 152a). Moreover, on December 22,

The bondholders now contend that the underwriting requirement should be secured by some kind of lien (such as a mortgage on the transferred New Haven assets), on the ground that the requirement would be an unsecured claim if Penn Central went into receivership before January 1, 1978. Clearly, the underwriting requirement accords unique protection to New Haven, alone among all of the Penn Central stockholders. Moreover, the questions as to whether the NH bondholders are entitled to still further protection, whether it is in fact feasible, and as to whether the Commission is empowered to prescribe it, are not properly before this Court because they have not yet been presented to or considered by the Commission or the courts below."

The approval of the underwriting approach by the Commission and the lower courts is fully con-

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1969, the reorganization court approved a stipulated abatement of $3.2 million of accrued real estate taxes owed the City of Boston (Order No. 596); the Commission had adjusted the price upwards for all the accrued real estate taxes. The settlement, therefore, further relieves the estate's future cash requirements.

Chase argued below that the directors of the reorganized company should be barred from selling any stock. The reorganization court in its "Step II" decision (not before this Court) responded to Chase's argument by refusing to bar the managers of the reorganized company from selling Penn Central stock as a matter of law. This was plainly correct; it can reasonably be anticipated that most of the stock will be retained.

[11] The bondholders also urge other matters not raised below, such as that Penn Central should bear the selling expense of the stock. Since these matters were never raised before the Commission and the lower courts they have been waived here. See *United States* v. *L. A. Tucker Truck Lines*, 344 U.S. 33, 36–38; *Unemployment Comm'n* v. *Aragon*, 329 U.S. 143, 155.

sistent with their approval of the issuance of stock. The underwriting requirement is merely an extension of the same security. As Judge Friendly stated,

> It must have been expected from the outset that a large portion of the purchase price would consist of PC stock and that this would not be immediately sold but rather would be held by the reorganized NH as a major long-term participant in what was expected to be a great and successful railroad system * * *. On the other hand, in the last analysis the market is the true appraiser and, if anticipations, no matter how well founded, should not be achieved, a proper adjustment should be made. We find Judge Anderson's solution of this difficult problem to be admirable * * *.[78]

D. PENN CENTRAL IS NOT REQUIRED IN FAIRNESS TO SHOULDER 100 PERCENT OF NEW HAVEN'S 1968 OPERATING LOSSES

In addition to the requirement that Penn Central lend the New Haven up to $25 million over a projected period of three years prior to inclusion, the Commission in its 1967 inclusion report imposed on Penn Central a share of New Haven's operating losses, not to exceed $5.5 million in any year. The three-judge court rejected the bondholders' argument on appeal from the inclusion report that Penn Central should be required to shoulder all New Haven's operating losses following the Penn Central merger.[79] The reorganization court not only agreed but had it-

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[78] 305 F. Supp. at 1064–1065, App. 430a.

[79] 289 F. Supp. at 443; App. 365a–366a.

self suggested a downward progression of Penn Central's participation in these losses.[80]

Inclusion, and hence Penn Central's control of New Haven operations, did not occur at the time of the merger (February 1, 1968) because of "the probable difficulties in reaching agreement for inclusion of the NH which will satisfy its bondholders" anticipated by this Court in the *Penn-Central Merger Cases,* 389 U.S. 486, 510. Following the issuance of the inclusion report in 1967, the bondholders in fact took the view that inclusion could not occur except as part of a complete reorganization plan.[81] They therefore did not seek to effectuate "Step 1" of the trustees' plan by requiring an immediate inclusion of New Haven, and it was not until the fall of 1968 that all bondholders waived objection to immediate inclusion.

For the most part, the bondholders now complain that the estate experienced millions of dollars of administration claims during the reorganization which take precedence over their claims. This is inconsistent with their earlier resistance to immediate inclusion. Moreover, these creditors "invested their capital in a public utility that does owe an obligation to the public." *Reconstruction Finance Corp.* v. *Denver & Rio Grande Western R.R.,* 328 U.S. 495, 535. Bondholders in the *Rio Grande* case were constitutionally required to absorb the costs of capital improvements during re-

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[80] 289 F. Supp. at 464; App. 255a.

[81] Indeed, their appeal to the United States Court of Appeals for the Second Circuit in *In the Matter of The New York, New Haven & Hartford Railroad Company,* 378 F. 2d. 635, decided May 29, 1967, sought to establish the illegality of an inclusion divorced from a complete reorganization plan.

organization proceedings; clearly the present bondholders did not experience an undue burden in absorbing a part of the operating losses through 1968.

The three-judge court held in a similar vein in 1968 that although the bondholders have a "constitutional right not to be required to operate the property at a perpetual loss, they did subject themselves to such interim losses as are reasonably incident to working out the solution most consistent with the public interest." [82] In the report on remand, the Commission advanced the actual inclusion date from a potential three years from the date of the merger to but eleven months thereafter and adhered to a ceiling of $5.5 million per year (or $5 million for 11 months) as Penn Central's maximum share of New Haven's 1968 operating losses. The three-judge court sustained the Commission's judgment in the matter; [83] and the reorganization court summarily dismissed the bondholders' attack on this item.[84] We submit that the Commission's allocation of the burden of interim losses was well within its discretion.

E. ADEQUATE AND FAIR VALUES WERE ASSIGNED NEW HAVEN'S NON-OPERATING PROPERTIES

A small portion of the New Haven assets conveyed to Penn Central by the New Haven was in the form of common stock in two enterprises which are jointly owned by various railroads. The New Haven held 50 percent of the stock in the New York Connecting Rail-

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[82] 289 F. Supp. at 444, App. 366a.
[83] 305 F. Supp. at 1063–1064, App. 428a.
[84] 304 F. Supp. at 811, App. 304a.

road (15,000 shares), and Penn Central held the remainder. New Haven also held about 4.5 percent of the stock of Railway Express Agency, Inc. (91,344 shares), and the remainder was owned by various other railroads.[85] The Committee urges that the Commission and the two lower courts erred in assigning these "non-operating" properties of the New Haven a zero value and requiring their transfer to Penn Central.

Witness Gordon testified for the New Haven trustees that both investments could not be given any dollar value in liquidation. He reasoned that the New York Connecting Railroad would have no value in liquidation since its funded debt ($18 million) greatly exceeded the salvageable value of its properties (less than $6.5 million).[86] He testified that the Railway Express stock would have "little if any liquidating value" based on the fact that an outside party's offer to buy the stock was in litigation, and recent legislation increasing the allowable size and weight of parcel post packages would probably have a detrimental effect on the company's earnings.[87]

The Commission adopted the valuation of the trustees' witness as reasonable, and rejected the argu-

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[85] The Committee also referred in its jurisdictional statement to certain certificates of contingent beneficial interest to be issued as part of the reorganization of the Boston & Providence Railroad. It now apparently abandons its objection to the zero valuation of those certificates, which, as both courts agreed, would have no value in the hands of Penn Central. See 304 F. Supp. at 810, App. 302a; 305 F. Supp. at 1061–1062, App. 423a–424a.

[86] Exh. NHI–42, p. 9, note 4; App. 49c.

[87] Exh. NHI–42, p. 9, note 6; App. 49c.

ments of the bondholders. The Commission stated: "The creditor groups presented no witness of their own in this area, and the expertise of the sponsoring witness for the NH trustees and the care with which he made his analyses are unquestioned." [88] The three-judge court declined in 1968 to question these purely factual determinations by the Commission, rejecting the bondholders' criticism "as seeking to have us invade the Commission's province." [89] The reorganization court expressly agreed.[90]

If the Committee is arguing that these assets had a greater liquidation value, the argument is contrary to the substantial evidence of record. Of course, if in fact the assets have a zero value, the New Haven was not harmed by the Commission's error, if any, in not leaving them with the estate. We submit, however, there was no error in the Commission's remaining consistent with the liquidation hypothesis and authorizing the transfer of these assets in rail-related enterprises to Penn Central at their liquidation value.

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[88] 331 I.C.C. at 678; App. 36a.
[89] 289 F. Supp. at 436; App. 350a.
[90] 289 F. Supp. at 461–462; App. 250a.

CONCLUSION

For the foregoing reasons, the Court should affirm the three-judge court's decree sustaining the decision of the Commission before the Court, and should reverse the decree of the reorganization court to the extent it is inconsistent therewith.

Respectfully submitted.

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MARCH 1970.

U.S. GOVERNMENT PRINTING OFFICE: 1970